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In The

Supreme Court of the United States

October Term, 1996

THEODORE VAN ZELST and LOUANN H. VAN ZELST, JEAN VAN ZELST-BIERNER, RALPH E. BROWN and SUZANNE BROWN, BRADLEY ORVIETO and ANNE L. ORVIETO, and THEODORE D. VAN ZELST,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the Seventh Circuit Court of Appeals erred by ruling, contrary to the decisions of the First and Ninth Circuit Courts of Appeal, that petitioners could not rely on the valuation opinion rendered by an expert recommended by the agency of government to which their charitable donation was made, and thus could be penalized because the expert's valuation was subsequently rejected.

2. Whether this Court's supervisory authority should be exercised to review the Seventh Circuit's contention that the National Park Service was improperly motivated to secure "sky-high appraisals", and its use of that contention to completely dismiss petitioners' reliance upon the Park Service's recommended expert, where the record below is wholly devoid of any evidence or argument to support that contention.

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OPINIONS BELOW

The Memorandum Opinion of the United States Tax Court, filed August 16, 1995, and attached to this Petition for Certiorari (see A. 18a-68a) is identified as T.C. Memo. 1995-396. It is reported at 70 T.C.M. (CCH) Dec. 50, 841(m). The opinion of the United States Court of Appeals for the Seventh Circuit, filed November 15, 1996, and attached to this Petition for Certiorari (see A. 1a-16a) is reported at 100 F.3d 1259. The Seventh Circuit's Order denying petitioners' Petition for Rehearing is also attached to this Petition (see A. 17a).

JURISDICTION

The judgment of the United States Court of Appeals for the Seventh Circuit was entered on November 15, 1996. Respondent's petition for rehearing was denied on January 15, 1997. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

At the time petitioners filed the tax returns relevant to this case, the following provisions of the Internal Revenue Service Code ("the Code") were in full force and effect.

Section 6653 of the Code.

(a) *Negligence*

(1) If any part of any underpayment . . . of tax required to be shown on a return is due

to negligence (or disregard of rules or regulations), there shall be added to the tax an amount equal to 5 percent of the underpayment.

* * *

(3) For purposes of this subsection, the term "negligence" includes any failure to make a reasonable attempt to comply with the provisions of this title, and the term "disregard" includes any careless, reckless, or intentional disregard.

Section 6659 of the Code.

(a) *Addition to the Tax*

(1) If an individual . . . has an underpayment of the tax . . . which is attributable to a valuation overstatement, then there shall be added to the tax an amount equal to the applicable percentage of the underpayment so attributable.

(b) *Applicable Percentage Defined.* For purposes of subsection (a) . . . if the valuation claimed is [more than 50 percent] of the correct valuation: . . . the applicable percentage is 30[%]

* * *

(e) *Authority to Waive.* The Secretary may waive all or any part of the addition to the tax provided by this section on a showing by the taxpayer that there was a reasonable basis for the valuation or adjusted basis claimed on the return and that such claim was made in good faith.

(f) *Special Rules for Overstatement of Charitable Deduction.*

* * *

(2) In the case of any underpayment attributable to a valuation overstatement with respect to a charitable deduction property, the Secretary may not waive any portion of the addition to tax provided by this section unless the Secretary determines that

(A) the claimed value of the property was based on a qualified appraisal made by a qualified appraiser, and

(B) in addition to obtaining such appraisal, the taxpayer made a good faith investigation of the value of the contributed property.

STATEMENT OF THE CASE

This case involves petitioners' 1985 donation of 247 acres of scenic Alaskan property to the United States Government at the government's express request and urging. Prior to the decision in this case, it was clearly established law that a sophisticated and knowledgeable taxpayer who donates property to charity can obtain an expert valuation opinion and reasonably rely on it for tax purposes without being required to "second-guess" the opinion. *McMurray v. Commissioner*, 985 F.2d 36, 43 (1st Cir. 1993); *Sammons v. Commissioner*, 838 F.2d 330, 337 (9th Cir. 1988). In this case, the United States Court of Appeals for the Seventh Circuit rejected this precedent by holding

that knowledge allegedly possessed by one of the petitioners, Theodore W. Van Zelst ("Van Zelst"), required Van Zelst as well as every other owner of an interest in the property (none of whom were alleged or shown to have any such knowledge) to second-guess an expert's valuation because they "had to have known that the . . . estimate was hooey. . . . " A. 15a.

The Seventh Circuit reached this conclusion despite the fact that petitioners' expert was specifically recommended by the National Park Service, a department of the very same government which now seeks to penalize petitioners for relying on this recommended expert. With no basis in the record, the Seventh Circuit found that the National Park Service "encourage[s] . . . sky-high appraisals" and accused the NPS of suborning fraudulent valuations of property for tax purposes ("the sort of valuation[s] ginned up to put one over on the revenooers.") A. 15a.

At the trial and appellate levels, petitioners raised a number of issues (disregarded by the courts) relating to the valuation of the subject property, as well as to the penalties and enhanced interest imposed against them. For purposes of this petition, only the issues regarding the penalties and enhanced interest imposed against petitioners will be discussed.

1. ***The Petitioners.*** Petitioners Theodore W. and Louann H. Van Zelst reside in Glenview, Illinois. R. 65, ¶ 1. Theodore W. Van Zelst ("Van Zelst") is a licensed civil engineer in Illinois, and an investor in large land development projects in northern Illinois and other

states. Louann Van Zelst is a homemaker. R. 65, ¶ 1; R. 76, pp. 396-397, 450-451, 471. It was Van Zelst and his wife who originally purchased the property which is at issue in this case, and later gave gifts of undivided portions of the ownership interest to the other petitioners. R. 65, ¶¶ 57, 64.

Most of the other petitioners are Van Zelst family members. Jean Van Zelst (Bierner), Van Zelst's daughter, resides in Wilmette, Illinois, where she is a science consultant for elementary schools. R. 65, ¶¶ 2, 114; R. 76, p. 473. Anne Orvieto, Van Zelst's other daughter, and her husband Bradley Orvieto reside in Plantation, Florida. Bradley Orvieto is employed as a financial planner and the President of 26th Street Venture, a limerock mining firm in Plantation, Florida, and Anne L. Orvieto is a homemaker and clinical dietician. R. 65, ¶¶ 4, 115, 116. Theodore David Van Zelst resides in Glenview, Illinois, and is employed as the President of Van Zelst, Inc., a landscape design and construction firm. R. 65, ¶¶ 5, 111.

Ralph Brown and Suzanne Brown, his wife, are the only non-Van Zelst family members among petitioners. Ralph Brown is a lawyer. His wife is a homemaker. They reside in Chicago, Illinois. R. 65, ¶¶ 3, 112, 113.

2. ***The Donated Property.*** The property at issue in this case (the "donated property" or the "property") consists of approximately 247 acres of scenic land located in the Wrangell-St. Elias National Park and Preserve in south-central Alaska. R. 65, ¶ 40. The National Park Service has described the scenery as follows: "[it far exceeds] the scale of Yosemite Valley in California and includ[es] an even greater diversity of geological elements." Jt. Ex.

41-AO. The Alaska Division of Mining refers to the claims as "being amongst the most significant mineral deposits in Alaska."

The donated property consists of 93.059 acres of "patented" property ("the patented property") and 154 acres of "unpatented" mining claims ("the unpatented property"). A patent grants its owner a fee simple interest in the property, and at the time of the donation in 1985 could be used for any purpose whatsoever. R. 75, p. 21. Unpatented claims entitle the claimant to sell, encumber or otherwise deal with the property for mining purposes. Unpatented claims can be patented if a showing is made that it is economically feasible to mine the property. Petitioners had taken steps to patent the unpatented claims. R. 75, p. 21; R. 76, p. 465; Jt. Ex. 83-CE. Pet. Ex. 107.

The unpatented property consists of six mining claims (covering approximately 123.96 acres) and six millsites (approximately 30 acres). R. 65, ¶ 38. The millsites provide housing and processing facilities to support the mining claims. The millsites on this property were held to be valid and appropriate for construction to support the mining claims, by the Interior Board of Land Appeals in 1983. R. 65, ¶ 39; Jt. Ex. 28-AB.

3. ***The Donation.*** In 1983, 1984 and 1985, Van Zelst and his wife, Louann, gifted 26.5% of their interest in the donated property in undivided interests to the other petitioners. R. 65, ¶ 71.

Van Zelst purchased the donated property from Cooper Industries in 1983, in what corporate officials described at trial as a "fire sale" related to their corporate

downsizing R. 65, p. 64. Van Zelst and the other owners then considered several options: a land exchange with the National Park Service and with the AHTNA Native Corporation involving the property; development of some or all of the property, either alone, or in conjunction with other investors; and a donation to the National Park Service. R. 65, ¶¶ 51-52; R. 76, p. 524. They decided on the donation option in response to direct requests made by the United States government on numerous occasions between 1983 and 1985. R. 65, ¶¶ 63, 69.

The donation took place on July 30, 1985. The government chose the donation date to accommodate the schedules of Secretary of the Interior Donald Hodel, Senator Stevens of Alaska, and the Director of National Parks. The Park Service issued a news release, and the gift was reported by the national news media. R. 76, pp. 483-484.

4. ***The Hawley Report.*** Shortly before the donation, consistent with the government's recommendation, petitioners had the property appraised by the Hawley Resources Group ("the Hawley Group" or petitioners' expert). The principals of the Hawley Resources Group were: C.C. "Chuck" Hawley ("Hawley"), a mining engineer with over 40 years of experience in Alaskan mining operations; William Shoemaker ("Shoemaker"), a business man with 18 years of experience in developing, financing, operating and selling recreational lodges in Alaska; and Toni Hinderman, Hawley's partner, who had done extensive explorations on the donated property. R. 75, p. 201; R. 76, p. 254. Pet. Ex. 106. Two of these principals, Hawley and Shoemaker, testified for petitioners at trial. These witnesses were qualified by the trial court as experts without objection from the government.

The Hawley Group valued the donated property at $2,750,000. Of this amount, $2,100,000 was assigned as the patented property's land value, based on its potential for development as a remote recreational resort. The remaining $650,000 was assigned for the mineral value present on the unpatented property if a small scale mining operation was conducted along the lines envisioned by the report's authors. The authors stated that over $1,300,000 in improvements had been made during the time that Van Zelst had been involved with the properties, but did not include this figure in their total. Pet. Ex. 106.

The Hawley Group's $2.1 million valuation of the patented property was based upon Shoemaker's analysis that a proposed resort lodge, to be operated under the conditions specified in the report, would be economically feasible so as to allow an investor to purchase the property for $2.1 million and receive a rate of return in excess of 15%. R. 76, pp. 275-276, 294, 301, 303, 308; Pet. Ex. 106.

The Hawley Group's $650,000 valuation of the unpatented property was based upon Hawley's conclusion that a proposed mining operation, to be operated under specific conditions, would generate a positive return of $650,000 over the 7 years of the proposed mine's operation, using a 10% discount rate. Hawley also opined because of its rich ore deposits, the property had a potential for a much greater value. Pet. Ex. 106.

Petitioners relied upon the valuation provided by the Hawley Group in valuing the donation for income tax purposes. R. 76, pp. 594-595; Jt. Exs. 42-AP, 48-AV. Petitioners also submitted the Hawley Group report to their

respective accountants and attorneys prior to valuing the donation on their tax returns, and relied on the advice of those accountants and attorneys. Pet. Ex. 106; Jt. Ex. 42-AP.

5. ***The Trial Court's Decision.*** On August 16, 1995 the tax court issued a 40 page opinion; it valued the property at $38,000 ($28,000 for the land and $10,000 for speculative value). With respect to the issue of petitioners' reliance on the Hawley Report, the court held that, as "sophisticated investors", they "should have known the Hawley Report grossly overstated the fair market value of the donated property." A. 56a. Accordingly, it imposed penalties and enhanced interest charges against petitioners.

6. ***The Appellate Court's Decision.*** On November 15, 1997, the United States Court of Appeals for the Seventh Circuit affirmed the decision of the trial court. With respect to the penalties issue, the appellate court wrote, in pertinent part:

> "Van Zelst was not an armchair investor dependent on others for his knowledge of the land's value; he was himself an expert . . . [h]e had to have known that the Hawley Group's estimate was hooey, the sort of number ginned up to put one over on the revenooers.
>
> What galls Van Zelst is the idea that the Internal Revenue Service has penalized him for relying on the National Park Service's favorite expert. His brief tells us (underlining in original): "*It was the government* which recommended Hawley. The Alaska Regional Director of National Parks specifically stated [to Van Zelst] that: '[h]e is the best you can get. We highly

> recommend him!' " . . . What the Regional Director defined as "the best" may not have been what the Commissioner or Congress had in mind. The Park Service wants to encourage donations, and sky-high appraisals do so."

A. 14a-15a.

On January 15, 1997, the appellate court denied petitioners' Petition for Rehearing. A. 17a.

REASONS FOR GRANTING THE PETITION

The Seventh Circuit's decision creates a conflict between the circuits which can only have a significant adverse national impact on charitable donations. In addition, the appellate court's unwarranted and unsupported statements about the National Park Service and its alleged complicity in overvaluations require the exercise of this Court's supervisory powers.

1. A Taxpayer Can And Should Reasonably Rely On An Expert Valuation Opinion Even If The Taxpayer Is Sophisticated And Knowledgeable About The Property Being Valued.

As noted earlier, this case involves petitioners' 1985 donation of 247 acres of scenic Alaskan property to the United States Government at the government's express request and urging. The following facts are undisputed:

> 1. Petitioners relied on the expert valuation report of the Hawley Group in reaching the

valuation shown on their tax returns. The government presented no evidence to the contrary;

2. The authors of the Hawley Report were qualified to do business and geological valuations owing to their lengthy and personal experience in Alaska in their respective fields of mining and resort development. Two of these individuals were qualified as expert witnesses by the Court;

3. Petitioners submitted the Hawley Report to their respective accountants, who reviewed the valuation of the potential gift, and passed on its reasonableness, and prepared their tax returns;

4. Petitioners were also counseled by their lawyers and accountants before making the donation and claiming the deduction on their tax returns;

5. Petitioners relied on technical reports by Dr. Mohan Sood, a noted geologist qualified as an expert by the Trial Court. Even the government's witness, Robert Paschall, testified that Dr. Sood's mineral reports were competent and well done; and

6. Petitioners submitted IRS Form 8283 reporting the valuation of the property. They also attached a copy of the Hawley Appraisal Report to each of their 1985 tax returns. A copy of the Hawley Appraisal Report was also given to the Regional Director of Alaskan National Parks who signed Form 8283.

R. 76, pp. 594-595; Jt. Exs. 42-AP, and 48-AV; Pet. Ex. 106.

Nevertheless, the petitioners have been penalized for doing exactly what they were told to do. The Seventh Circuit, relying on its conclusion that Van Zelst was

knowledgeable and sophisticated, stated that he "should have known" not to rely on the Hawley valuation, and then imputed his knowledge to the other taxpayers although no allegation has ever been made that the other taxpayers had any special knowledge or expertise in valuing property or that they had any reason not to rely on the expert valuation. The decision is in direct conflict with decisions rendered by other appellate courts which hold that a taxpayer does not need to second-guess the valuation of a qualified expert. If allowed to stand, the opinion will have serious and adverse national impact with respect to the giving of gifts or donations by taxpayers to charity.

A. The Instant Case Creates A Conflict Among The Circuits.

In *McMurray v. Commissioner*, 985 F.2d 36 (1st Cir. 1993), the First Circuit Court of Appeals stated that a taxpayer who makes a charitable donation of property, obtains an expert appraisal, and takes a tax deduction based on the appraisal should not be subject to a negligence penalty if the fair market value of the property is ultimately determined to be less than the value assigned by the appraiser. In *McMurray*, plaintiffs claimed a value greatly in excess of the value ascribed to the property by the Commissioner. The Commissioner's value was upheld by the Tax Court. The basis for petitioner's claim rested upon an expert valuation opinion which, as in the instant case, was based upon a discounted cash flow analysis of a hypothetical business operation which could theoretically be constructed on the subject property. The

McMurrays were experienced and sophisticated, and they admittedly were knowledgeable as to real estate development in the area. Nonetheless, the appeals court held neither the McMurrays' "knowledge," nor the "minimal probative value assigned by the tax court to the McMurrays' expert," was enough to "requir[e] them to second-guess a licensed appraiser . . . [it] does not mandate a finding of bad faith or unreasonable reliance." 985 F.2d at 43

In *Sammons v. Commissioner*, 838 F.2d (9th Cir. 1988), the Commissioner argued that " . . . because Mr. Sammons is a successful and sophisticated businessman, he should have known that it was unreasonable to claim a deduction in an amount that far exceeded the cost of the donated items, especially when the items had been held for such a brief period before the donation was made." 838 F.2d at 337. This is the same argument made by the government and adopted by the Seventh Circuit in this case. There, however, in direct contravention to the decision of the Seventh Circuit, the Ninth Circuit Court of Appeals held that it was not unreasonable to rely on "exceptionally well qualified appraisers . . . " *Id.*[1]

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[1] The Fifth and Tenth Circuit Courts of Appeal have also endorsed this general principle in the context of expert accounting advice. *See Mauerman v. Commissioner*, 22 F.3d 1001, 1005 (10th Cir. 1994) ("although he [Mauerman] had been an investor for over two years, it is not reasonable to expect that Mauerman could monitor his independent advisors . . . [i]t is exactly for this reason that many intelligent investors have independent, educated experts to advise them . . . Mauerman acted in good faith under these circumstances in relying on his independent advisors."); *Chamberlin v. Commissioner*, 66 F.3d 729, 733 (5th Cir. 1995) ("To require the taxpayer to challenge the

This case stands in stark contrast to this well-established law. As in *Sammons*, petitioners' expert in this case was "exceptionally well qualified." Hawley was, according to the government itself, the best you can get." R. 76, p. 475. As in *McMurray*, petitioners' expert valued the property based upon a hypothetical business operation being run on the property (the efficacy and appropriateness of valuing unimproved land by the discounted cash flow method has been sanctioned by many courts, including the Supreme Court of Alaska (where the subject property is located) in *Dash v. State*, 491 P.2d 1069 (Alaska 1971)).[2] Both cases, as here, involved appraisal valuations many times that paid by the taxpayers to purchase property. In flat contradiction to these cases, however, the Seventh Circuit held that Van Zelst's alleged "expertise" should have led him to reject the opinion of his well-qualified valuation expert, precisely because of the methodology used and the difference between the appraisal price and the earlier acquisition cost of the then encumbered property.

[expert] to seek a 'second opinion,' or to try to monitor [the expert] . . . would nullify the very purpose of seeking the advice of a presumed expert in the first place"). As in the *Mauerman* and *Chamberlin* cases, petitioners also relied on the advice of independent counsel and accountants.

[2] *See also Ramsey County v. Miller*, 316 N.W.2d 917 (Minn. 1982); *In Estate of Goldman v. Commissioner of Finance*, 609 N.Y.S. 2d 241 (A.D. 1 Dept. 1994); *Resolution Trust Corp. v. Board of County Com'rs of County of Arapahoe County*, 860 P.2d 1383, 1387 (Colo. App. 1993); *Cherokee Water Co. v. Gregg County Appraisal District*, 773 S.W.2d 949 (Tex. Civ. App. 1989), aff'd 801 S.W.2d 872 (Tex. 1990); *Dept. of Transportation and Development v. Hammons*, 550 So.2d 767 (La. App. 1989)

The Seventh Circuit's recitation of "facts" alleged to have been known to Van Zelst cannot differentiate this case from the *McMurray* and *Sammons* cases. The Hawley Group expert knew the facts when it reached its valuation conclusions. To hold, as the Seventh Circuit did, that petitioners should have known that The Hawley Group was wrong is to require petitioners to substitute their judgment for that of qualified experts and advisers. This holding is squarely the opposite of that reached by the First, Fifth, Ninth and Tenth Circuits.

B. The Seventh Circuit's Decision In The Instant Case Was Erroneous And Should Be Reversed In Favor Of The Decisions Rendered By Other Courts Of Appeal.

This Court should resolve the conflict between the decision issued by the Seventh Circuit Court of Appeals in this case, and those opposite decisions reached by other appellate courts. It is respectfully submitted it should do so by reversing the Seventh Circuit's erroneous interpretation of the law.

First, the Seventh Circuit's decision requires that a taxpayer independently evaluate and investigate an opinion reached by a qualified expert to avoid negligence penalties. There is no basis for reaching this conclusion, which equates the requirements necessary to avoid a negligence penalty (reasonable reliance on a qualified expert) with that for a valuation overstatement penalty (reasonable reliance on an expert *and* independent investigation). In *McMurray*, the First Circuit upheld a valuation overstatement penalty while reversing a negligence

penalty precisely because the avoidance of valuation overstatement penalties required an additional step on the part of the taxpayer – an independent investigation – which the taxpayers in *McMurray* admittedly did not conduct. Specifically, the Court held that a failure to independently investigate, or "second-guess" an appraiser subjected the McMurrays to valuation overstatement penalties, but their reliance on the expert insulated them from negligence penalties.

In the case at bar, the petitioners did make a good faith investigation independent from the valuation conducted by their expert, and submitted extensive comparable sales data supporting the appraised valuation to the government. This investigation, which proved petitioners' reliance on the valuation to be reasonable, can only be viewed as further evidence of petitioners' good faith, and should exempt them from both negligence and valuation overstatement penalties, as well as enhanced interest.

Second, the Seventh Circuit's decision necessarily offends the national public interest by placing all donors of real and personal property at risk for high penalties if the appraisal obtained by them is later rejected. This obviously reduces the incentive to taxpayers to make charitable gifts. To take a tax deduction for a charitable gift, the donor must value the property being donated. The fairest, and most efficient, way to do this is to use an independent expert. What the Seventh Circuit has done in this case is to say to taxpayers: "You cannot rely on an independent, well-qualified valuation expert in determining the worth of your donated property, because you may be penalized afterward if the Internal Revenue Service

disagrees with the expert's conclusions. Nor, for that matter, can you avoid being penalized by doing your own independent, good faith investigation."

The effect and fundamental inequity of this decision cannot be overstated. Petitioners in this case donated property at the request of the government, used the expert recommended by the government to value the property, and wound up being penalized by the government for so doing in an amount far in excess of what the government now claims the property itself is worth. This risk is not limited to donors of property to the government; it is all-encompassing in its applicability to donations. Gifts to museums, universities, charitable organizations, and the like will be affected. Under these circumstances, the number of people willing to donate property in the public interest will be greatly reduced.

The problem is even more acute in this case because the Seventh Circuit, without any support from or reference to the record, held that all of the petitioners were guilty of negligence. There is no support in the record or any indication that any of the other petitioners were "expert[s]," the conclusions reached by the Seventh Circuit with respect to Van Zelst.[3] There is simply no basis in case law, statutory or regulatory authority for the proposition that the purported expertise of one property owner is, as a matter of law, arbitrarily assignable to other owners who independently relied on expert advice.

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[3] The government has, at all times in this case, asserted that Van Zelst was *not* an expert in real estate valuation. R 76, pp. 500-501. This point was totally ignored by the Seventh Circuit, which arbitrarily declared him to possess "expertise."

Nonetheless, the Seventh Circuit, by fiat, improperly imposed vicarious liability on the remaining taxpayers.

In short, the Seventh Circuit's decision to penalize petitioners for relying on the Hawley Group's valuation was contrary to law, public policy and common sense. It should be reversed.

2. This Court Should Exercise Its Supervisory Powers to Overturn The Seventh Circuit's Inappropriate And Unsupported Denigration of the National Park Service And Its Unwarranted Reliance On Same.

As noted previously, taxpayers should be permitted to rely on qualified valuation experts without fear of being penalized for doing so. It is passing strange that these taxpayers should not have been permitted to rely on this expert, who was enthusiastically endorsed by the government. In an attempt to overcome the obvious inconsistency between the government's recommendation of an expert, and its subsequent imposition of penalties because that very expert was relied upon, the Seventh Circuit impugned the integrity of the National Park Service, attributing to it a desire to encourage "sky-high appraisals." This Court's supervisory authority should be exercised to revoke the Seventh Circuit's contention, and its reliance thereon.

Simply put, the record is utterly devoid of evidence relating to the Park Service seeking overvaluations. Nor is there any evidence as the Court below suggests that the Park Service is somehow at odds with the Commissioner

of the Internal Revenue Service, or the Congress on questions relating to valuation. This was not an issue at trial, was not an issue on appeal, and was never advanced as a position by the government, which, in fact, called as a witness a Park Service employee (Kit Mullen). But, despite this lack of evidence, the Seventh Circuit unjustly accused the Park Service of aiding these taxpayers (and others) in a conspiracy to "put one over on the revenooers." A. 15a.

Petitioners do not simply disagree with the reviewing court's interpretation of the facts. They claim error because the Seventh Circuit has introduced and relied on "facts" such as this one that were not only outside the record but were never even raised by the parties in argument or otherwise.[4] To denigrate the Park Service's recommendation of Hawley by asserting, without support, that the Park Service had a motive to encourage overvaluation of property is egregious, and cannot be condoned. It "so far depart[s] from the accepted and usual course of judicial proceedings . . . as to call for an exercise of this Court's power of supervision." U.S. Supreme Court Rule 10.1(a).

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[4] Another example is the appellate court's heavy reliance on a travel guide, *Foder's Alaska* (1994) (*see* A. 2a), which (a) was produced nine years after the date of donation; (b) was never offered in evidence or argument or even cited by any party in the record; and (c) contained conclusions dramatically at odds with the evidence which was presented.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

THEODORE VAN ZELST and LOUANN VAN ZELST, JEAN VAN ZELST-BIERNER, RALPH E. BROWN and SUZANNE BROWN, BRADLEY ORVIETO and ANNE L. ORVIETO, and THEODORE D. VAN ZELST

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In the
United States Court of Appeals
For the Seventh Circuit

No. 96-1833

THEODORE W. VAN ZELST, *et al.*,

Petitioners-Appellants,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee.

Appeal from the United States Tax Court
Nos. 22030-90 *et al.* – **Julian I. Jacobs,** *Judge.*

ARGUED NOVEMBER 1, 1996 – DECIDED NOVEMBER 15, 1996.

Before CUMMINGS, BAUER, and EASTERBROOK, *Circuit Judges.*

EASTERBROOK, *Circuit Judge.* Canada's Mt. Logan, at 19,524 feet the second tallest peak in North America, and Alaska's Mt. St. Elias, at 18,008 the fourth, are the crowns of the world's greatest coastal range of mountains. Six other peaks (Bona, Blackburn, and Sanford in Alaska; Lucania, King, and Steele in the Yukon) top 16,000 feet. Mount Wrangell, at 14,163 feet roughly the size of Mt. Rainier and still growing, vents steam and ash at its summit. Air laden with moisture from the warm Japan Current flowing through the Gulf of Alaska is propelled 15,000 feet upward by this rocky front, losing 60° F in the process. Down comes the snow, and more snow, and

more snow. Glaciers, one of them (the Malaspina) the size of Delaware, flow from the mountains to the sea; the Bagley Icefield is 4,000 feet thick and 90 miles long. Peaks still unnamed await their first ascent. In the upper elevations, Dall sheep and mountain goats are kings. Bears, moose, and wolves rule below. In 1980 the core of the Wrangell and St. Elias ranges in the United States, plus the eastern reach of the Chugach range, became the Wrangell – St. Elias National Park and Preserve, which contains 9 of the 16 highest peaks in the United States. The Park and Preserve, combined with the adjoining Kluane National Park in Canada, comprises 20 million acres of rugged and inaccessible terrain. Only two dirt roads enter the Park, and using them is an adventure in itself:

> The park is largely wilderness, with limited services available in the ghost towns of McCarthy and Kennicott. To get there, you will need a sturdy four-wheel-drive vehicle. Take the Richardson Highway to the Edgerton Cutoff. Drive 35 miles to the head of the McCarthy Road at the village of Chitina. The road is 58 miles of dirt, with one spectacularly terrifying crossing of a deep river gorge on an old railroad trestle. At the end of the road, you must park and cross the Kennicott River on two separate hand-pull trams. These trams are extremely dangerous; wear gloves and watch out for the pulley wheels, which have lacerated many fingers. Also, take care to avoid falling into the racing river below you.

Fodor's Alaska 228 (1994). If you get across safely, McCarthy is five miles to the east. On foot.

Today McCarthy and points beyond are destinations for mountain climbers, cross-country skiers, big-game hunters, and wilderness hikers. Years back, the dominant breed was prospectors. If "Kennicott" sounds familiar, it is because of the Kennecott Copper Company, which extracted 591,535 tons of copper and 9 million ounces of silver from a mine at the town of Kennecott, five miles north of McCarthy. Mine, town, and company were named after the nearby Kennicott Glacier, itself named after the explorer Robert Kennicott. (Prospectors weren't all that keen on spelling.) This single deposit was worth more than all the gold discovered in the Yukon Gold Rush. When the vein was exhausted in 1938, the works and milltown were abandoned. The railroad right-of-way became the dirt road that now (almost) connects Chitina and McCarthy. But the tectonic and volcanic processes that concentrated copper near the Kennicott Glacier were at work over a wider area, and prospectors fanned out. They staked hundreds of claims in the mountains. About 742,000 acres of land within the boundaries of the Park and Preserve are in private hands today. Yet all of the claims are inactive. Nary a producing mine exists in the area, not because the ore is poor but because the climate is harsh and transportation a daunting obstacle. Kennecott Copper Company built a railroad from its mine along the Chitina and Copper rivers to the port at Cordova, a feat that cannot be duplicated because the national government owns the land surrounding the claims and will not permit an extension of the railroad inside the Park. Materials would have to be hauled in, and minerals removed, by air or by giant all-terrain vehicles. Roaring glacier-fed braided rivers hamper overland

movement during the warm season, and dependence on air transport would so increase costs that mines could not compete with rivals elsewhere in the world that operate year-round with cheap land or water access.

Ninety-three acres of land some 18 miles east of McCarthy, the "Nelson Mine," were patented to private owners in 1939. A "land patent" is equivalent to fee simple ownership. The Nelson Mine lies between 2,700 and 3,700 feet in elevation on the north side of a mountain above Glacier Creek, less than a mile upstream from its confluence with the Chitistone River. Across Glacier Creek from the Nelson Mine is a gravel airstrip owned by the National Park Service – but neither a bridge nor a tram spans this outwash, which drains Mt. Bona's Twaharpies Glacier (and several lesser glaciers) and cannot be forded during daytime in warm weather. The Park Service is not apt to allow a bridge to be built. The property has a steep gradient, making it hazardous for helicopters to land. Difficulties have not prevented exploration, however, and by 1979 more than $1.3 million had been spent on tests and improvements, such as cabins and mountaintop helipads. Viable operations proved elusive, and by 1979 Geneva-Pacific Corporation, the mine's owner, and Cenco Corporation, its parent, were out of money to continue. After a series of transactions, Cooper Industries came to own Geneva-Pacific and thus the Nelson Mine, which it put on the market in 1982 – first for $500,000 and then for $250,000. No one made an offer.

T.W. Van Zelst was the principal manager of Geneva-Pacific from its founding in 1969 until Cooper acquired that corporation. By 1982 Cooper was anxious to get rid of unproductive mining properties. When he left Geneva-

Pacific's employ in 1983, Van Zelst took with him the Nelson Mine plus 154 acres of nearby mineral interests including the Peavine, Radovan, Greenstone, and Binocular Prospect claims. The United States retains the surface interest in these unpatented lands, which we call the Peavine parcel for convenience. Both the Nelson Mine and the Peavine parcel are in the Preserve rather than the Park, and are outside the designated wilderness zone, so economic development is legally permissible. Van Zelst paid Cooper a total of $30,174 for the 247 acres in the Nelson and Peavine parcels. The sale was subject to an option that allowed Cenco to repurchase a partial interest if mining should commence by June 1, 1985. In 1983 Cenco was entitled to buy 30 percent of the land for roughly $500,000; it was offered the properties under this option but declined. Cooper retained another 10,000 or so acres of land in Alaska but could not figure out how to make a profit by exploiting them. It put the lot of them up for sale; no one offered to buy a single parcel for any price. Mining properties in Alaska faced not only the problems of extraction and the vicissitudes of the market but also the costs of environmental compliance; it was and remains possible for accumulated developmental efforts to give land a negative value. In June 1983 Cooper gave the whole 10,000 acres back to the United States.

Between 1983 and 1985 T.W. Van Zelst gave fractional interests to some of his friends and relatives; we call him and the recipients "Van Zelst" for convenience, because their behavior and legal interests are identical. On July 30, 1985, two months after Cenco's option expired, Van Zelst followed Cooper's example and donated the property to the United States. Secretary of the Interior Hodel

issued a press release praising the donors' public spiritedness. Soon Van Zelst gave the United States cause to question that characterization. He deducted from his income, for tax purposes, the value of the Nelson and Peavine properties. According to Van Zelst, that value on July 30, 1985, was $2.75 million, so the tax benefits vastly exceeded the purchase price of $30,000, the present value of the revenue flow (zero), and the competing offers Cenco had received for the parcels (none).

Eventually the Commissioner of Internal Revenue disallowed the deductions, and the Tax Court held a trial to fix the fair market value of the property on the date of donation. See *McM[illegible]ray v. CIR*, 985 F.2d 36, 40 (1st Cir. 1993); 26 U.S.C. § 170(a)(1); 26 C.F.R. § 1.170A-1(c)(1). Van Zelst's position was based on an appraisal from the Hawley Resource Group, Inc., which opined that the property could produce 100 tons of 5 percent copper ore per day five months of each year, with minerals hauled to Cordova, more than 100 miles away, by cat-trains each November after the rivers froze. (Fuel and materials would be carted in during April, before the spring thaw.) The present value of this operation in 1985, the Hawley Group concluded, was $650,000. This was backed up by the opinion of geologist Mohan Sood, who testified that the mineral resources were adequate to support the proposed rate of extraction. The remainder of the value, according to the appraisal, was attributable to the potential for a resort lodge at the Nelson Mine.

Diane Black-Smith, a real estate appraiser with extensive experience in Alaska properties (including properties in the Wrangell – St. Elias National Park and Preserve) testified for the Commissioner that this valuation was

fantasy. Actual sales fetched only $400 to $650 per acre between 1975 and 1988, she testified – and she believed that the Nelson Mine property was inferior to these parcels because of high slope, restricted access, and location on the north side of the mountain, where lack of direct sunlight in the summer (when at the Park's latitude the sun follows the southern horizon) would make it a poor resort. She gave the Nelson Mine a value of $300 per acre, for a total of $28,000. Robert Reilly, an economist, and Luther Clemmer, a mining engineer, critiqued the mineral aspects of the Hawley Group report. They concluded that any copper mine in the area would have a negative cash flow, spending $99 per ton to extract ore worth $70 per ton. Robert Paschall, a geologist, observed that four corporate owners had found the Nelson Mine unprofitable when the price of copper was as high as 97cents per pound; on the date of donation, when copper fetched 67cents, the property was not a prospect for development. Paschall noted that in 1985 mining was uneconomic "at giant active copper mines in Utah, Arizona, and South America. It was thus not a time when even the most optimistic of miners would have invested in small deposits in a remote location that was subject to long and stormy winters."

Judge Jacobs concluded that the Hawley Group's appraisal was unrealistic and determined that the Nelson and Peavine parcels together were worth $38,000 in mid-1985. 70 T.C.M. 435 (1995). No resort along the lines of the Hawley Group's proposal exists in or near the Park and Preserve, and the judge thought the Nelson Mine an unlikely site for the first, given access, slope, and sunlight

considerations. Developers would choose better properties from among the 700,000+ acres in private hands (plus additional land in Canada, and more in the U.S. outside the Park). Our review is deferential, *Orth v. CIR*, 813 F.2d 837, 842 (7th Cir. 1987), and we cannot call this decision clearly erroneous. Evidence was presented on both sides; the trier of fact was entitled to choose. *Anderson v. Bessemer City*, 470 U.S. 564 (1985). Van Zelst contends that Black-Smith did not select the appropriate parcels to compare with the Nelson Mine, and that she never set foot on the property (her helicopter could not land safely), but the former is a question for the Tax Court to resolve and the latter is irrelevant. Our own view, to the extent it matters, is that the trial judge was on the mark. The absence of any similar resort in the area speaks far more loudly than a paper proposal. Developers can choose better properties if they decide that a mountain lodge would be profitable. Van Zelst argues that the Nelson Mine woul ' have been uniquely attractive because the tourists could have visited a working mine; but these days the back-country devotees who make pilgrimages to Alaska are more likely to be repulsed by equipment gouging 100 tons of rock daily from the mountain than they are to be attracted by the smell of diesel exhaust and the thunder of explosions that blast the rocks loose and overwhelm the sounds of nature.

Indeed, the appraisal is nonsense on its own terms. It should not have required the award of the 1996 Nobel Prize in Economics to William Vickrey, a pioneer of auction theory, to remind people that the market price of an asset depends on the *second*-most-productive use to which it can be put. See R. Preston McAfee & John

McMillan, *Auctions and Bidding*, 25 J. Econ. Lit. 699 (1987). Suppose three parcels of private land in the Park are equally suitable to be the site of a resort that will bring its developer $2 million after costs of construction and operation. How much will the developer pay for the land? That depends on what else the owners can do with their land, as the developer will shop for the lowest price. Suppose Parcel *A* has a vein of ore with a present value of $650,000, and Parcels *B* and *C*, which lack minerals, are suitable only for subsistence hunting and fishing (value $10,000). The owner of Parcel *A* will not sell for less than $650,000, but the owners of Parcels *B* and *C* will sell for anything over $10,000. The developer will not pay $650,000 to the owner of Parcel *A*, when he can get land for so much less elsewhere, so Parcel *A* is worth only $650,000 as the value of its second-best-use, a mine. If there were no Parcel *C*, the developer and the owner of Parcel *B* would reach a deal in the range between $10,000 and $650,000: the developer never pays more than $650,000 (for he can turn to Parcel *A*), and the owner never takes less than $10,000 (for he can keep the land in its current use). When there is a Parcel *C*, a threat to buy it instead of Parcel *B* helps the developer chisel the price down, unless the owners collude. As the number of available sites rises, the possibility of collusion declines. When there are hundreds of potential sites (as there are in the Park and Preserve), the price the developer must pay falls to the competitive level. To put this otherwise, *land* is not a scarce resource in these mountains; financing and entrepreneurship are the scarce ingredients, so they will capture the economic return of resort development. Yet the Hawley Group's appraisal attributed to the Nelson Mine

100 percent of the (potential) economic profit of a resort development. It did not offer a rationale for that allocation. At oral argument Van Zelst's lawyer tried to supply one by saying that the number of potential resort-mine combinations in the vicinity is small, but for reasons we have already explained even a "small" number of rivals allows the developer to capture the returns – if there are any returns to the odd combination of luxury resort and rock crushing.

As for the Hawley Group's estimate that the properties were worth $650,000 in mining: the court found, with ample support in the record, that mining 18 miles east of McCarthy would have been unprofitable in 1985 and the foreseeable future. The land had some value as an option to open a mine if the price of copper should rise or the costs of extraction fall; that value, the court thought, was $10,000. Added to Black-Smith's estimate of $28,000, this produced a total value of $38,000. The conclusion is not clearly erroneous. Once again actions speak more loudly than appraisals. There was in 1985, and is today, *no* operating mine in the area, for precisely the reason the court gave: high costs of extraction.

In approving the Tax Court's conclusion, we do not place any weight on an injunction, entered six days before the donation, that forbade mineral development in the Park without prior judicial approval. *Northern Alaska Environmental Center v. Hodel*, No. J85-009 CIV (D.Alaska July 24, 1985), affirmed, 803 F.2d 466 (9th Cir. 1986). The injunction was not lifted until January 2, 1991. Van Zelst and a supporting *amicus* brief argue, with considerable force, that this injunction – based as it was on failure of the federal government to discharge its responsibilities

under the environmental laws – cannot be turned to the federal government's benefit by virtue of its adverse effect on the value of private holdings. Harm done by the government is a reason to compensate the private owners, see *Nollan v. California Coastal Commission*, 483 U.S. 825, 833-34 n.2 (1987); *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003 (1992), not to capitalize the harm into a lower value of the land. *Florida Rock Industries, Inc. v. United States*, 791 F.2d 893, 905 (Fed.Cir. 1986). For current purposes, therefore, we endeavor to evaluate the land's worth with legally unlimited development potential. Still, the Tax Court held that this value was negative in 1985, given the combination of high extraction costs and the low market price of copper. That finding – based on economic as well as legal limits – is copiously supported.

Having held that the claimed deduction exceeded the land's market value by almost two orders of magnitude, the Tax Court sustained the Commissioner's decision to impose penalties under 26 U.S.C. §§ 6653(a) and 6659 for negligent disregard of the rules governing the calculation of tax and for substantial overvaluation. The sections establishing these penalties have been amended and consolidated for more recent tax years; we refer to the versions in force at the time. Section 6653 provided that any underpayment attributable to negligence leads to an extra tax equal to 5 percent of the underpayment, plus an increase of 50 percent in the interest on the underpayment. The Commissioner has the burden of establishing the taxpayer's negligence, and the court held this burden satisfied because Van Zelst's use of the Hawley Group report was not

> reasonable, prudent, and in good faith. [Van Zelst is a] sophisticated investor[ ]. [He] should have known the Hawley Report grossly overstated the fair market value of the donated property. [He] should have been aware that nothing had occurred to substantially increase the value of the property between the time [he] purchased the property and the time it was donated. Indeed, with regard to the mineral interests, copper prices were declining. And, [he] should have realized that the hypothetical resort was unrealistic and that at the time of donation mining was . . . not economically feasible. Common sense should have come into play.

70 T.C.M. at 447. Section 6659(b) provided for a tax equal to 30 percent of the underpayment, when the deduction claimed exceeds 250 percent of the property's market value. The Tax Court found that Van Zelst's claim was 7237 percent of the donated property's worth, so this requirement was satisfied, and to spare. The chasm between true value and the amount claimed as a deduction showed that the Commissioner had not erred in declining to remit the penalty, the court held. 70 T.C.M. at 448.

Van Zelst believes that the Tax Court was unduly influenced by an inappropriate benchmark: the $30,000 he paid for the parcels. He contends, and the Commissioner agrees, that a bargain purchase does not diminish the market value of the property or cap the deduction. A donor to a charitable institution (including the government) may deduct more than his basis in the property, sometimes without recognizing gain on the difference. The $30,000 figure was misleading for three reasons, Van

Zelst submits: first, in 1983 the land was encumbered by the Cenco repurchase option; second, Cooper received valuable consideration in addition to the cash price; third, Cooper just didn't know the value of the land and therefore did not obtain top dollar. The third of these may be true, but it is hardly an argument Van Zelst should want to advance. Geneva-Pacific owned the parcels, and Van Zelst, as the firm's principal manager, owed it a duty of loyalty – including a duty not to transact with the corporation for a price less than the market value of the properties, without full disclosure of the difference to the board (which represented the interests of Cooper, by then Geneva-Pacific's parent corporation). Van Zelst was an employee of Cooper too. He does not contend that he disclosed his current high estimate of the land's worth, and because Van Zelst presents himself as an honest entrepreneur we must assume that he paid the market price as of 1983. That price may have been depressed by the Cenco option, but the effect could not have been great, for the option expired in two years and the owner had only to wait it out before developing the land. (Even in 1983 Cenco's option covered only 30 percent of the interest and had a hefty strike price.) That leaves Van Zelst's argument that non-cash consideration boosted the effective price of the land. Unless the real price was $1.1 million or more, the claimed deduction still exceeded 1983 market value by 250 percent, and nothing in this record supports an inference that Van Zelst gave Cooper more than $1 million in non-cash consideration. Van Zelst tells us that in exchange for the land he gave up: rights to 5 percent of all profits from mineral operations in more than 15,000 acres of Alaska lands; employment as a senior

executive of Cooper (and, with employment, participation in its stock option and pension plans, plus accrued leave); and any legal claims against Cooper, such as a claim for age discrimination. What's missing, as the Tax Court observed, is any effort to put a value on the rights surrendered. When Van Zelst closed the deal on the Nelson and Peavine parcels, Cooper was just about to give its mineral-bearing lands to the United States, and 5 percent of nothing is . . . worthless. What the other items may have been worth to Cooper was left to the trial court's imagination. Not good enough, the court thought, for a subject on which Van Zelst bore the burden of persuasion. Right it was.

There remains an argument that the Hawley Group's appraisal not only precludes the negligence enhancement but also compels the Commissioner to conclude that the taxpayer acted reasonably and in good faith (which would preclude the over-valuation enhancement). An appraisal may show that the taxpayer acted both prudently and reasonably, but it does not compel this inference. Under § 6659 it is not reliance on an estimate, but *reasonable* reliance that mitigates the penalty. Although negligence is an "ultimate issue," appellate review remains deferential. *Accardo v. CIR*, 942 F.2d 444, 452 (7th Cir. 1991); *Forseth v. CIR*, 845 F.2d 746, 749 (7th Cir. 1988). Cf. *Pullman-Standard v. Swint*, 456 U.S. 273, 285-90 (1982). Taxpayers cannot reflexively blame their experts (or their attorneys) and avoid penalties when things go wrong. *United States v. Boyle*, 469 U.S. 241 (1985). Van Zelst was not an armchair investor dependent on others for his knowledge of the land's value; he was himself an expert, who also knew the number of resorts in the area (zero),

the price of copper (67cents and falling), the number of corporations that had owned the Nelson Mine without figuring out how to make a profit (four), the number of years the claim had lain fallow since the patent issued (46), the number of producing copper mines near the Park (none), what the land sold for in 1983 ($30,000), the highest competing bid for the Nelson Mine (zero), and the highest bid Cooper had received for any of its other parcels (zero). He had to have known that the Hawley Group's estimate was hooey, the sort of number ginned up to put one over on the revenooers.

What galls Van Zelst is the idea that the Internal Revenue Service has penalized him for relying on the National Park Service's favorite expert. His brief tells us (underlining in original): "*It was the government* which recommended Hawley. The Alaska Regional Director of National Parks specifically stated [to Van Zelst] that: '[h]e is the best you can get. We highly recommend him!' " This is a tad misleading; before this conversation took place, Van Zelst already had decided to retain the Hawley Group. What the Regional Director defined as "the best" may not have been what the Commissioner or Congress had in mind. The Park Service wants to encourage donations, and sky-high appraisals do so. The Park Service cannot bind the Revenue Service either directly or indirectly; Van Zelst has acknowledged this. What is more, there is a difference between C.C. Hawley, the geologist who has served on several governmental advisory committees and whose name so excited the Regional Director, and the Hawley Resource Group, Inc., which Van Zelst engaged. C.C. Hawley's contribution was a mineralogical assessment, which as things turned out was subordinate

to economic considerations. William E. Shoemaker was responsible for valuation of the resort prospect. It was the ludicrous attribution of $2.1 million to this unlikely turn of events that propelled the parcel's total valuation into the stratosphere. The Tax Court did not exceed the scope of the reasonable in its evaluation of these events.

AFFIRMED

A true Copy:
Teste:

Clerk of the United States Court of Appeals for the Seventh Circuit

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604

January 15, 1997.

Before

Hon. WALTER J. CUMMINGS, Circuit Judge

Hon. WILLIAM J. BAUER, Circuit Judge

Hon. FRANK H. EASTERBROOK, Circuit Judge

THEODORE W. VAN ZELST, *et al.* *Petitioners-Appellants,* **No. 96 1833** **v.** COMMISSIONER OF INTERNAL REVENUE, *Respondent-Appellee.*	Appeal from the United States Tax Court. Nos. 2203090 *et al.* Julian I. Jacobs, *Judge.*

Order

Petitioners appellants filed a petition for rehearing and suggestion of rehearing en banc on December 30, 1996. No judge in regular active service has requested a vote on the suggestion of rehearing en banc, and all of the judges on the panel have voted to deny rehearing. The petition for rehearing is therefore DENIED.

T.C. Memo. 1995-396

UNITED STATES TAX COURT

THEODORE W. VAN ZELST AND LOUANN H. VAN ZELST, ET AL.,[1] Petitioners v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket Nos. 22030-90. 22031-90, 22032-90, 22033-90, 22034-90. Filed August 16, 1995.

Stephen Joseph Morrow and *Jeffrey E. Schiller*, for petitioners in docket Nos. 22030-90, 22031-90, 22033-90, and 22034-90.

Stephen Joseph Morrow and *Ralph E. Brown*, for petitioners in docket No. 22032-90.

Scott M. Estill and *Patricia Pierce Davis*, for respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

JACOBS, *Judge*: Pursuant to notices of deficiency dated July 19, 1990, respondent determined the following deficiencies in, and additions to, petitioners' Federal Income taxes:

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[1] The following cases are consolidated herewith: Jean Van Zelst, docket No. 22031-90; Ralph E. and Suzanne Brown, docket No. 22032-90; Bradley and Anne L. Orvieto, docket No. 22033-90; and Theodore D. Van Zelst, docket No. 22034-90.

Theodore W. and Louann H. Van Zelst, Docket No. 22030-90:

Year	Deficiency	Additions to Tax and Additional Interest			
		Sec. 6653(a)(1)[1]	Sec. 6653(a)(2)	Sec. 6659	Sec. 6621(c)
1985	$ 7,643	$ 382.15	2	$2,293	3
1986	12,764	638.20	2	3,829	3
1987	21,647	1,082.35	2	6,464	3

Jean Van Zelst, Docket No. 22031-90:

Year	Deficiency	Additions to Tax and Additional Interest			
		Sec. 6653(a)(1)[1]	Sec. 6653(a)(2)	Sec. 6659	Sec. 6621(c)
1985	$1,621	$ 81.05	2	$ 468.30	3
1986	5,305	265.25	2	1,592.50	3
1987	7,327	366.35	2	2,198.10	3

Ralph E. and Suzanne Brown, Docket No. 22032-90:

Year	Deficiency	Additions to Tax and Additional Interest			
		Sec. 6653(a)(1)[1]	Sec. 6653(a)(2)	Sec. 6659	Sec. 6621(c)
1985	$24,810	$1,240.50	2	$ 7,443.00	3
1986	34,231	1,711.55	2	10,269.30	3
1987	1,577	78.85	2	473.10	3

1 The additions to tax for negligence or intentional disregard of rules or regulations are codified under sec. 6653(a)(1)(A) and (B) for 1986 and 1987.

2 50 percent of the interest due on the deficiency.

3 120 percent of the interest due on the entire deficiency. Pursuant to the Tax Reform Act of 1986, sec. 1151(c)(1), Pub. L. 99-514, 100 Stat. 2744, former sec. 6621(d) was redesignated as sec. 6621(c).

Bradley and Anne L. Orvieto, Docket No. 22033-90:

Year	Deficiency	Additions to Tax and Additional Interest: Sec. 6653(a)(1)[1]	Sec. 6653(a)(2)	Sec. 6659	Sec. 6621(c)
1985	$ 1,225	$ 61.25	2	$ 367.50	3
1986	8,216	410.80	2	2,464.80	3
1987	19,151	957.55	2	5,745.30	3

Theodore D. Van Zelst, Docket No. 22034-90:

Year	Deficiency	Additions to Tax and Additional Interest: Sec. 6653(a)(1)[1]	Sec. 6653(a)(2)	Sec. 6659	Sec. 6621(c)
1985	$ 1,754	$ 87.70	2	$ 526.20	3
1986	5,616	280.80	2	1,684.80	3
1987	23,774	1,188.70	2	7,132.20	3

[1] The additions to tax for negligence or intentional disregard of rules or regulations are codified under sec. 6653(a)(1)(A) and (B) for 1986 and 1987.

[2] 50 percent of the interest due on the deficiency.

[3] 120 percent of the interest due on the entire deficiency. Pursuant to the Tax Reform Act of 1986, sec. 1151(c)(1), Pub. L. 99-514, 100 Stat. 2744, former sec. 6621(d) was redesignated as sec. 6621(c).

Pursuant to amended answers filed on August 11, 1992,[2] respondent increased petitioners' deficiencies and additions to tax to the following amounts:

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[2] The notices of deficiency were based on a property appraisal prepared for respondent. While respondent did not repudiate this original appraisal, the amended answers are based on new appraisals prepared by different experts (discussed hereinafter).

Theodore W. and Louann H. Van Zelst, Docket No. 22030-90:

		Additions to Tax and Additional Interest			
Year	Deficiency	Sec. 6653(a)(1)[1]	Sec. 6653(a)(2)	Sec. 6659	Sec. 6621(c)
1985	$16,444	$ 822	2	$ 4,933	3
1986	35,016	1,751	2	10,505	3
1987	32,801	1,640	2	9,840	3

Jean Van Zelst, Docket No. 22031-90:

		Additions to Tax and Additional Interest			
Year	Deficiency	Sec. 6653(a)(1)[1]	Sec. 6653(a)(2)	Sec. 6659	Sec. 6621(c)
1985	$4,482	$224	2	$1,345	3
1986	6,464	323	2	1,939	3
1987	7,327	366	2	2,198	3

Ralph E. and Suzanne Brown, Docket No. 22032-90:

		Additions to Tax and Additional Interest			
Year	Deficiency	Sec. 6653(a)(1)[1]	Sec. 6653(a)(2)	Sec. 6659	Sec. 6621(c)
1985	$31,272	$1,564	2	$ 9,382	3
1986	34,231	1,712	2	10,269	3
1987	1,577	79	2	473	3

Bradley and Anne L. Orvieto, Docket No. 22033-90:

		Additions to Tax and Additional Interest			
Year	Deficiency	Sec. 6653(a)(1)[1]	Sec. 6653(a)(2)	Sec. 6659	Sec. 6621(c)
1985	$ 3,527	$176	2	$1,058	3
1986	12,813	641	2	3,844	3
1987	19,151	958	2	5,745	3

Theodore D. Van Zelst, Docket No. 22034-90:

		Additions to Tax and Additional Interest			
Year	Deficiency	Sec. 6653(a)(1)[1]	Sec. 6653(a)(2)	Sec. 6659	Sec. 6621(c)
1985	$ 4,841	$ 242	2	$1,452	3
1986	6,975	349	2	2,093	3
1987	23,774	1,189	2	7,132	3

[1] The additions to tax for negligence or intentional disregard of rules or regulations are codified under sec. 6653(a)(1)(A) and (B) for 1986 and 1987.

[2] 50 percent of the interest due on the deficiency.

[3] 120 percent of the interest due on the entire deficiency. Pursuant to the Tax Reform Act of 1986, sec. 1151(c)(1), Pub. L. 99-514, 100 Stat. 2744, former sec. 6621(d) was redesignated as sec. 6621(c).

This case concerns petitioners' 1985 donation to the National Park Service of 93 patented and 154 unpatented acres of undeveloped land (the donated property), located in the Wrangell-St. Elias National Park and Preserve (the Park). The issues for decision are: (1) The fair market value of the donated land at the time of donation; (2) whether all petitioners, other than Ralph E. and Suzanne Brown, failed to properly elect the 50-percent limitation regarding their respective contribution bases for 1985, 1986, and 1987; (3) whether petitioners are liable for additions to tax for negligence or intentional disregard of rules or regulations; (4) whether petitioners are liable for additions to tax for valuation overstatements; and (5) whether petitioners are liable for additional interest.

All section references are to the Internal Revenue Code in effect for the years under consideration. All Rule references are to the Tax Court Rules of Practice and Procedure.

FINDINGS OF FACT

Some of the facts have been stipulated and are found accordingly. The stipulations of facts and the attached exhibits are incorporated herein by this reference.

Background

All petitioners are members of the Van Zelst family, with the exception of Ralph and Suzanne Brown. Theodore W. (T.W.) and Louann H. Van Zelst are the parents of Jean Van Zelst, Anne Orvieto, and Theodore D. Van

Zelst. Bradley Orvieto is T.W. and Louann Van Zelst's son-in-law.

Petitioners T.W. and Louann H. Van Zelst, husband and wife, resided in Glenview, Illinois, at the time they filed their petition herein. T.W. Van Zelst is a civil engineer specializing in soils and rock, and an investor in large development projects.

Petitioner Jean Van Zelst resided in Wilmette, Illinois, at the time she filed her petition. She is a science consultant for elementary schools.

Petitioners Ralph and Suzanne Brown, husband and wife, resided in Chicago, Illinois, at the time they filed their petition. Mr. Brown is an attorney.

Petitioners Bradley and Anne Orvieto, husband and wife, resided in Plantation, Florida, at the time they filed their petition. Mr. Orvieto is a financial planner and president of 26th Street Venture, a Plantation, Florida, limerock mining firm.

Petitioner Theodore D. Van Zelst resided in Glenview, Illinois, at the time he filed his petition. He is president of Van Zelst, Inc., a landscape design, construction, and management company.

1. The Donated Property[3]

The donated property is located in the Chitistone River Valley area of Alaska. The Park was created by the

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[3] Our findings with regard to the donated property consider the property's status as of July 30, 1985, the date of donation.

Alaska National Interest Lands Conservation Act on December 2, 1980. The Park covers 13.2 million acres, including vast areas of extremely rugged, high-mountain terrain.[4]

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[4] A 1986 National Park Service Official Map and Guide of the Wrangell-St. Elias National Park and Preserve describes the Park, in part, as follows:

> This is a park for wilderness-oriented activities. Travel services and facilities are limited. Visitors are mostly on their own here and thus must be highly self-motivated and self-sufficient.
>
> * * *
>
> There are few trails, so most hiking is across what appears to be previously untraversed terrain.
>
> * * *
>
> Assistance may be days or miles away, so be extraordinarily careful in this vast region. You must possess proper survival gear and skills to handle mountainous terrain.
>
> * * *
>
> Hikers must be familiar with safe techniques for crossing rivers and streams. Many are impassable, even for experts. Others can change from trickling creeks to raging torrents quickly, so be especially cautious.

On May 7, 1977, T.W. Van Zelst testified before the House Subcommittee on General Oversight and Alaska Lands and described the area as dangerous and inaccessible.

The donated property consists of 93 patented[5] acres (Nelson Mine property or patented acres) and 154 unpatented[6] acres (Peavine property or unpatented acres).[7] The donated property is located on the north side of a mountain, approximately 18 miles east of McCarthy, Alaska, and approximately 230 air miles northeast of Anchorage. It is located on the southwest side of Glacier Creek, above the creek bed, and .75 mile upstream from the confluence of the Chitistone River and Glacier Creek. Several structures exist on the donated property, but they are in a state of disrepair. The property is remote and access is difficult.

a. The Nelson Mine Property

Glacier Creek separates the Nelson Mine property (which contains six mining claims) from an unpaved,

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[5] Generally, a patent on property grants its owner a fee simple interest in the property, allowing for actual surface ownership of land.

[6] Unpatented acres provide only subsurface or mineral rights.

[7] The Nelson Mine property is known as Spruce Claim Numbers 1 through 6, designated as Survey No. 1588, located in the McCarthy Mining District in the State of Alaska, and contains approximately 93.059 acres. The Peavine property involves the following lode mining claims (consisting of approximately 123.6 acres): Peavine Numbers 2 and 5; Triassic Numbers 70 and 71 (Binocular); and Boots-Agusta (Greenstone Mine). The unpatented acres also involve 6 unpatented mill site claims (consisting of approximately 30 acres) at the Peavine Mill sites.

gravel airstrip.[8] The presence of Glacier Creek, whose current in the spring and summer is dangerous and generally impossible to cross by foot, makes it difficult to reach the Nelson Mine property from the airstrip.[9] Thus, access to the patented acres is limited to helicopters or small-wheel planes. In addition, it is impossible to drive a vehicle on the property's trails due to heavy vegetation growth.

The majority of the terrain at the Nelson Mine property is quite steep. The patented acres start at 2,700 feet above sea level and rise to a 3,700-foot elevation over a distance of 2,360 feet. The land has an 86-percent slope facing east/northeast. Because of this slope, it is dangerous for helicopters to land on the patented acres.

b. The Peavine Property

The unpatented acres are located approximately 5 miles from the patented acres, near the Chitistone Trailhead. An unpaved gravel airstrip also exists near the Peavine property. Rock slides are common in the area. The main mineral content of the unpatented acres is copper.

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[8] The National Park Service owns the land upon which this airstrip is located.

[9] No trams or bridges cross Glacier Creek near the airstrip or the patented acres, and the patented acres are not directly accessible by continuous roads or bridges.

2. Ownership History of the Donated Property

On or about September 26, 1969, Geneva Pacific Corporation (Geneva Pacific) purchased the Nelson Mine property. Geneva Pacific was a research company located in Evanston, Illinois, that field tested seismic and electrical resistivity instruments and conducted mineral exploration. T.W. Van Zelst was founder and president of Geneva Pacific.[10] His first visit to the patented acres was on Geneva Pacific's behalf.

Ownership of Geneva Pacific changed hands several times during the 1970's. In the mid-1970's, Cenco, Inc. (Cenco),[11] held a 50-percent interest in Geneva Pacific. In 1981, Cooper Industries (Cooper)[12] acquired Geneva Pacific. As part of this acquisition, Cooper acquired the Nelson Mine property as well as the unpatented acres.[13] T.W. Van Zelst operated and managed the donated property on Cooper's behalf. Geneva Pacific was dissolved in 1983.

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[10] From 1969 through 1979, T.W. Van Zelst was president of Geneva Pacific Corp. (Geneva Pacific). From May 1, 1980 through Apr. 30, 1983, he was its general manager.

[11] Cenco, Inc. (Cenco) based in Chicago, Illinois, was a manufacturer and distributor of science and educational equipment. T.W. Van Zelst was an officer and director of Cenco in the late 1970's.

[12] Cooper Industries (Cooper), located in Houston, Texas, manufactured energy tools and electrical devices.

[13] While the record is unclear, it appears that the unpatented acres were part of 10,000 acres of unpatented Alaskan mining claims that Cenco had originally acquired by purchase and staking. In the 1970's, Cenco transferred its interest in the 10,000 acres to Geneva Pacific.

Both Geneva Pacific and Cooper attempted to mine copper and other minerals at the donated property but found it economically unfeasible to do so. Geneva Pacific filed patent applications with respect to the unpatented acres in February 1982, but withdrew the applications in February 1984.

3. Sale of Donated Property to T.W. Van Zelst

Cooper attempted to sell the donated property beginning in 1982, first for $500,000, and then for $250,000, but received no offers. Cooper became eager to sell the donated property because of its desire to dispose of its Geneva Pacific holdings. Ultimately, on April 30, 1983, Cooper sold the donated property to T.W. Van Zelst[14] in connection with the termination of his employment with Geneva Pacific and Cooper. The purchase price for the property consisted of two elements: (1) $30,174; and (2) T.W. Van Zelst's waiver of any royalty rights he had under his Geneva Pacific employment contract.[15] Concurrent with his real property purchase, T.W. Van Zelst purchased from Cooper an International Harvester Scout II vehicle for $3,000, and various other personal property for $6,826.

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[14] Cooper intended to donate its 10,000 Alaskan acres to the National Park Service, but T.W. Van Zelst made Cooper an offer on the donated property. This was the only offer Cooper received for any of the Alaskan land it possessed. After the sale to T.W. Van Zelst, on June 1, 1983, Cooper donated its remaining acres to the National Park Service.

[15] The record does not contain any substantiated evidence regarding the dollar value for the royalty rights.

T.W. Van Zelst's purchase of the donated property was subject to an April 23, 1979, condition executed by Geneva Pacific and Cenco, whereby Cenco had a right to buy back a percentage interest in the property.[16] The Cenco option was to expire on June 1, 1985. The option was executed after Cenco sold its interest in Geneva Pacific, and was intended to avoid possible embarrassment to Cenco if copper were discovered after the transaction.

During the period that T.W. Van Zelst owned the donated property, he neither improved nor attempted to mine the property.[17] Further, he neither filed patent applications nor was awarded a patent with respect to any of the unpatented acres.

4. Donation to the National Park Service

While retaining a 73.5-percent interest for himself and his wife, T.W. Van Zelst gave the remainder of the patented and unpatented acres to the other petitioners involved herein. On October 10, 1983, T.W. Van Zelst gave undivided percentage interests to the other petitioners as follows: Jean Van Zelst (6 percent); Anne Orvieto (6 percent); Bradley Orvieto (3.5 percent); Theodore D. Van Zelst (6 percent); and Mr. Brown (5 percent).

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[16] The Cenco option applied to all of Cooper's Alaskan real estate, including the donated property.

[17] The price of copper substantially decreased between Apr. 1983 (77 cents per pound) and July 1985 (67 cents per pound). The copper industry did not begin to recover until 1988.

On November 1, 1984, T.W. Van Zelst and Mr. Brown discussed the possible donation of the subject property to the National Park Service.[18] On July 30, 1985, petitioners donated the Nelson Mine property and the unpatented acres to the National Park Service.

At the time of donation, the donated property was subject to an injunction. The injunction was entered on July 22, 1985, by the U.S. District Court for the District of Alaska. The injunction, which was motivated by environmental concerns, precluded mining activity in Alaskan National Parks without court approval.[19]

5. Petitioners' Federal Income Tax Returns

On petitioners' 1985 Federal income tax returns, they calculated the amount of their charitable contribution deductions based on their respective percentage-ownership interests in the donated property. They attached Forms 8283, Noncash Charitable Contributions Appraisal Summary, to their returns, disclosing the donation of the property to the National Park Service. Attached to the Forms 8283 was a certification of appraiser C.C. Hawley, of the Hawley Resource Group, Inc., valuing the donated property at $2,750,000. Petitioners each used a 50-percent

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[18] T.W. Van Zelst had discussions with the National Park Service regarding a possible donation of the subject property as early as Feb. 1983 (i.e., before he owned the property). He was well aware of the tax savings resulting from such a charitable donation.

[19] We note that the injunction was dissolved on Dec. 28, 1990. However, as of the date of donation, there was no indication when or if the injunction would be lifted.

ceiling on the returns in calculating their charitable contributions at issue. Petitioners carried over the unused portions of their charitable contribution deductions to their 1986 and 1987 returns.

ULTIMATE FINDING OF FACT

The fair market value of the donated patented and unpatented acres on July 30, 1985, the date of donation, was $38,000.

OPINION

Issue 1. Fair Market Value of the Donated Property

The first issue for decision is the fair market value of the donated property for purposes of determining the proper amount of petitioners' charitable contribution deductions. The notices of deficiency determined the fair market value to be $286,500. Petitioners have the burden of proving that the fair market value of the donated property exceeds the value determined by respondent in the notices of deficiency. Rule 142(a); *Estate of Gilford v. Commissioner*, 88 T.C. 38, 50-51 (1987); *McGuire v. Commissioner*, 44 T.C. 801, 806 (1965). By amendments to answers, however, respondent redetermined the fair market value of the donated property to be $28,000, thereby increasing the originally determined deficiencies and additions to tax. Respondent bears the burden of proving the increases in the deficiencies and additions to tax asserted in the amended answers. Rule 142(a); *Estate of Bowers v. Commissioner*, 94 T.C. 582, 595 (1990).

Section 170 allows an individual to deduct charitable contributions, subject to certain percentage limitations, with a carryover of any excess contributions. See sec. 170(b), (d). If a charitable contribution is made in property other than money, the amount of the contribution is the fair market value of the property at the time of the contribution. Sec. 1.170A-1(c), Income Tax Regs. Fair market value is "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having a reasonable knowledge of relevant facts." Sec. 1.170A-1(c)(2), Income Tax Regs.

The fair market value of donated property as of a given date is a question of fact to be determined from the entire record. *Symington v. Commissioner*, 87 T.C. 892, 896 (1986); *Zmuda v. Commissioner*, 79 T.C. 714, 726 (1982), *affd.* 731 F.2d 1417 (9th Cir. 1984). The fair market value of property reflects the highest and best use of the property[20] on the date of valuation. *Stanley Works v. Commissioner*, 87 T.C. 389, 400 (1986). Determination of fair market value is not dependent upon whether the property is actually being put to its highest and best use. Rather, it is the realistic, objective potential use to which the property can be put. *Id.; see also Mitchell v. United States*, 267 U.S. 341, 344-345 (1925); *United States v. Meadow Brook Club*, 259 F.2d 41, 45 (2d Cir. 1958); *Hilborn v. Commissioner*, 85 T.C. 677, 689-690 (1985). Respondent

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[20] The "highest and best use" is defined as the most economic use which is reasonably probable. American Institute of Real Estate Appraisers, The Appraisal of Real Estate 124 (3d ed. 1988).

maintains that the highest and best use of the property is as a remote recreational cabin site. Petitioners maintain that the highest and best use of the property is as a full-scale developed recreational resort. Respondent's experts opined that the fair market value of the donated property on the date of donation was $28,000. In contrast, petitioners' experts opined that the fair market value on the date of donation was $2,750,000.

As the trier of fact, we must weigh the evidence presented by the experts in light of the demonstrated qualifications of the experts in addition to all other credible evidence. *Estate of Christ v. Commissioner*, 480 F.2d 171, 174 (9th Cir. 1973), affg. 54 T.C. 493 (1970). However, we are not bound by the opinion of any expert witness when that opinion is contrary to our judgment. *Estate of Kreis v. Commissioner*, 227 F.2d 753, 755 (6th Cir. 1955), affg. T.C. Memo. 1954-139; *Chiu v. Commissioner*, 84 T.C. 722, 734 (1985). We may accept or reject expert testimony as we find appropriate in our best judgment. *Helvering v. National Grocery Co.*, 304 U.S. 282, 294-295 (1938); *Seagate Tech., Inc. & Consol. Subs. v. Commissioner*, 102 T.C. 149, 186 (1994).

I. The Parties' Experts

A. Valuations of Petitioners' Experts

1. The Hawley Report

Close to the time of donation, petitioners requested an appraisal of the donated property by C.C. Hawley, Toni K. Hinderman, and William E. Shoemaker of the

Hawley Resource Group, Inc.[21] The June 30, 1985, appraisal report (Hawley Report), prepared mainly for investment purposes, concluded that the donated property's "current value" was $2,750,000.[22] This figure comprises $2,100,000 for the fee simple interest of the patented acres and $650,000 for the donated property's mineral interests. The Hawley Report based its valuation on (1) the hypothetical use of the patented acres as a seasonal recreational resort, and (2) the potential for mineral development on the donated property.

The Hawley Report valuation of the patented acres assumes the highest and best use of the property to be a

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[21] The Hawley Resource Group, Inc., is engaged in consulting and contracting work. C.C. Hawley received a Ph.D. in geology from the University of Colorado. He has 33 years of experience in that field and is registered as a professional geologist in Alaska and Oregon. Toni K. Hinderman is an economic geologist with an M.S. from Stanford University. He has 18 years of experience in that field. William E. Shoemaker received a B.A. in business administration from the University of Notre Dame. He has 10 years of business experience in Alaska. He has owned and operated a lodge, and has real estate experience. We note that at the time of the appraisal Mr. Hawley was familiar with the donated property inasmuch as he did consulting work with respect to the potential for mineral development of the donated property as early as 1973.

[22] In their respective petitions petitioners state that "the value for the Van Zelst Group Alaska Lands according to the Hawley Appraisal is conservative", and that "the Van Zelst Group Alaska Lands on July 30, 1985, were worth in excess of $4,600,000" to account for mining improvements, scenic beauty, and recreational value. It appears from the record that petitioners have abandoned this position.

commercial recreational lodge. In this regard, the following assumptions were made: (1) The resort would be open only in the summer season (June 1 through September 30); (2) a variety of possible activities would be offered to guests, including wildlife and nature photography, hiking, horseback riding, river rafting, helicopter tours, and recreational mining; (3) the facility would provide its guests with transportation to and from the resort; and (4) while access to the patented acres was limited, roads, trails, and air fields located on or near the property would be used in connection with the recreational development.

Mr. Shoemaker prepared that portion of the Hawley Report addressing the proposed resort development on the patented acres.[23] Believing that no other comparable land sales existed, he utilized the income stream or discounted cash flow approach to determine the "current value" of the patented acres. Pursuant to this approach, Mr. Shoemaker determined the "current value" of the patented acres to be $2,100,000.[24] He arrived at the $2,100,000 amount by projecting costs and revenues of the hypothetical operation over time, and discounting the value of earnings for each year after the first year of operation to account for the rate of return that an investor

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[23] Mr. Shoemaker did not visit the donated property.

[24] Mr. Shoemaker wrote, "the land value would be based on the profit the owners would expect to make from the operation of a lodge or what profit opportunity is being forgone if the land is sold." The Hawley Report assumed that these values would be the same.

would expect to achieve on a present value basis.[25] He concluded that an individual who invested $2,100,000 to purchase the patented acres would achieve a 17-percent rate of return if the development were resold in the 11th year after construction. This return, he asserted, would induce an investor to purchase the patented acres for $2,100,000.

The Hawley Report considered the anticipated copper mining project to be of a small scale but that the properties would have the potential to be mined profitably.[26] The Report stated that "the proposed development of any mine has to be viewed as one of high risk." The Report concluded that the "current value" of the mineral interests on the date of donation was $650,000. At trial, Mr. Hawley admitted that this amount was but an estimate.

The Hawley Report contains several plans for starting and carrying out the proposed mining project: (1) Operating a small mine producing 100 tons of salable minerals (largely copper) per day; (2) operating the mine for only 5 months (spring and summer months) per year to keep down higher mining costs that would occur in winter; and (3) the use of cat-trains and trucks, rather than helicopters, to transport the recovered minerals. The

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[25] Mr. Shoemaker predicted that the project's construction costs would be $1,800,000. He also assumed a selling price of 2.5 times the gross revenues.

[26] In valuing the donated property, the Report did not consider the July 22, 1985, injunction against mining in Alaskan National Parks without court approval.

Hawley Report concluded that 90,000 tons of salable minerals would be recoverable from the proposed mining operation.[27] Mr. Hawley determined that with an initial $900,000 investment and $700,000 in annual operating expenses, the mining operation would turn a $650,000 profit (using a 10-percent per year adjustment figure) based upon expected costs of $46.60 per ton[28] and expected revenues of $75 per ton (using 1985 mineral prices).

2. The Sood Report

Petitioners also presented Dr. Mohan Sood as an expert witness.[29] Dr. Sood is a geologist who spent the summers of 1979 and 1981 studying the donated property's mineralization and reserved for Geneva Pacific. He

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[27] However, Mr. Hawley testified that more than half of the 90,000 tons of reserves were either potential or inferred ore rather than proven reserves.

[28] Mr. Hawley arrived at a $46.60 per ton cost by the following calculation:

	Cost Per Ton
Labor	$26.40
Supplies	11.33
Freight	2.67
General & Admin.	6.20
	46.60

At trial, Mr. Hawley adjusted the per ton cost from $46.60 to $52.60.

[29] Dr. Sood received a Ph.D. in geology from the University of Western Ontario, in London, Canada. He is the Dean of the Graduate College of Northeastern Illinois University. Formerly, he was chairperson of the University's Department of Earth Sciences.

wrote a report for Geneva Pacific in September 1980 (submitted as evidence at trial) detailing the mineralization of the property. The report stated that "the investigations of the structure, petrography and chemistry of rocks and minerals show close similarity to the deposits of Kennicott, Alaska, which are considered one of the world's largest deposits of this kind and produced huge quantities of copper metal until its closure in the 1930's." In his report, Dr. Sood made the following recommendations to Geneva Pacific: (1) Engage in systematic exploration and development; (2) map the anomalous areas in detail thereby facilitating the exact interpretation of the size of the deposit; (3) drill to confirm the extension of the ore deposits; and (4) conduct a geophysical survey in the drill holes to ascertain the extent of mineralization.

At trial, Dr. Sood concluded that there were sufficient mineral reserves on the donated property to support the Hawley Report's proposed mining operation.

B. Valuations of Respondent's Experts

1. The Black-Smith Report

Respondent's first expert, Diane Black-Smith, is a real estate appraiser with Black-Smith & Richards, Inc.[30] Ms.

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[30] Ms. Black-Smith received a B.A. from the University of Washington. She has approximately 20 years of appraisal experience. She is a member of the American Appraisal Institute. In Dec. 1980, she established the firm of Black-Smith & Richards, Inc., an Anchorage real estate appraisal company. She is past president of Alaska Chapter No. 57 of Real Estate Appraisers, and was appointed as the Alaska State Coordinator for Legislation in the appraisal industry in 1988.

Black-Smith has experience appraising properties in the Park.

Ms. Black-Smith prepared an appraisal report, dated July 10, 1992, regarding the vacant 93 patented acres (excluding mineral rights).[31] Respondent did not ask her to value the remaining 154 unpatented acres or the sub-surface interests of the donated property.[32]

Ms. Black-Smith utilized the comparable sales approach to value the patented acres. She testified that this approach is the most credible and best approach to value vacant land. As a result of the general downturn of the Alaskan economy, property sales in the market area were limited in the mid-1980's. Thus, the comparables she selected were Park property sales occurring between

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[31] On July 9, 1992, Ms. Black-Smith visited the patented acres. She was unable to tour the property physically, but viewed it from the air. The helicopter in which she flew was unable to land on the property because of its steep slope. Ms. Black-Smith's helicopter was able to land across from the patented acres at the Glacier Creek airstrip, but the Glacier Creek's raging waters prevented her from crossing the creek to the patented acres. Ms. Black-Smith presented at trial a videotape of the property that she filmed from the helicopter, which was accepted into evidence.

As background information, Ms. Black-Smith reviewed numerous on-site photographs of the patented acres taken in Aug. 1985 by Kit Mullen, resource specialist with the National Park Service. Mrs. Black-Smith also interviewed National Park Service personnel who completed a site survey of the Nelson Mine property.

[32] We note that two experts, Messrs. Clemmer and Paschall, valued the mineral interests of both the patented and unpatented acres for respondent. See *infra* pp. 25-28.

1975 and 1988, with sales prices ranging from $400 to $650 per acre.[33] The comparable properties all have: (1) Size and access similar to the patented acres (i.e., access is only by air; none of these properties are on a road system); (2) superior topography; (3) superior development potential; and (4) location on the south slope of mountains (with plenty of sunlight). After making adjustments for various inequalities on an item-by-item basis[34] and taking the inferior characteristics of the patented acres into account, Ms. Black-Smith concluded that the fair

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[33] Petitioners argue that Ms. Black-Smith's report should have referred to another report she prepared regarding land in the Park similar to the donated property. The property addressed in Ms. Black-Smith's other report was located at May Creek. Ms. Black-Smith testified that she did not use the May Creek property as a comparable to the Nelson Mine property because it was a government acquisition and was thus not considered to be a market sale. In the May Creek Report, Ms. Black-Smith used the comparable sales approach to value the May Creek property at $1,100 per acre. This is substantially higher than the comparables used in her Nelson Mine Report. However, Ms. Black-Smith testified that the May Creek property was "far superior" to the patented acres at issue herein for several reasons: (1) It was the "gateway to the park" and was used as a staging area for hunters and other activities in the Park; (2) it had level topography; (3) it was located between two rivers in a valley and thus had a superior location; (4) it bordered a state-maintained airstrip and had easier access; and (5) it had on-site improvements that were in good condition. Thus, while we agree with petitioners that Ms. Black-Smith should have discussed the May Creek property in her Nelson Mine Report, we do not agree that the $1,100 per acre figure is relevant to the fair market value of the donated property.

[34] Ms. Black-Smith used land characteristics such as location, size, time of sale, topography, and soil conditions to adjust the fair market value.

market value of the Nelson Mine property was $300 per acre on the date of donation, for a total fair market value of $28,000.[35]

In Ms. Black-Smith's view, due to the existence of the surrounding Park and the remoteness of the area, the highest and best use of the patented acres is as a remote recreational cabin site or public park land, rather than as a developed recreational resort. She testified that three negative characteristics render the patented acres unsuitable for recreational development: (1) Its steep slope; (2) limited access; and (3) location on the north side of a mountain (receiving less sun and therefore less desirable). In her view, market demand for recreational subdivisions in the area was limited between 1983 and 1987. Ms. Black-Smith also testified that a commercial recreational development would not be feasible due to the availability of other, far superior vacant tracts in the area.

2. The Reilly Report

Robert F. Reilly,[36] of Willamette Management Associates, recreated and critiqued the methodology that the

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[35] Ms. Black-Smith testified that she did not consider the amount T.W. Van Zelst paid for the donated property in reaching the $28,000 fair market value.

[36] Mr. Reilly received a B.A. in economics and an M.B.A. in finance from Columbia University. He is a certified real estate appraiser, and a member of the National Association of Real Estate Appraisers. He is Willamette Management Associates' managing director for appraisal and valuation consulting services. Prior to his association with Willamette Management Associates, Mr. Reilly was both a partner and national director of the Deloitte and Touche Valuation Group.

Hawley Report used to value the patented acres.[37] The Reilly Report reached the following conclusions:

> (1) The Van Zelst Group property fee simple interest valuation, which measures the net present value of the net cash flow of a hypothetical recreational lodge * * * is based on an incorrect definition of value.[38] The correct definition of value for the subject appraisal is fair market value.
>
> (2) The HRG [Hawley] valuation opinion report incorrectly concludes that the net present value of the net cash flow of a hypothetical recreational lodge is an indication of, in fact equal to, the "current value" of the land. The correct conclusion is that the net present value of the net cash flow of the hypothetical recreational lodge equals the value of the recreational lodge business entity.[39]

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[37] Mr. Reilly's report did not discuss the donated property's mining potential.

[38] The Reilly Report took issue with the Hawley Report's "use value" of the patented acres. The Hawley Report's use value analysis assumed that other assets, such as buildings and facilities, "are actually in an operating configuration and are generating a predictable, identifiable income stream". The Reilly Report asserted that, because the proposed recreational facility is a hypothetical and speculative project, reliance on the use definition for determining the property's fair market value is "inappropriate". The Reilly Report concluded that the values used in the Hawley Report are neither equal to fair market value nor consistent with generally accepted real estate appraisal methods regarding fair market value of land.

[39] In essence, the Reilly Report states that the discounted net cash flow or income approach used in the Hawley Report is appropriate as an indication of fair market value only where the

(3) The net present value of the hypothetical recreational development using the discounted net cash flow approach, as of July, 1985, is negative $312,000, after making adjustments for incorrect assumptions made by HRG are incorporated into their model. This negative net present value means that no prudent or rational investor would make the economic decision to undertake the construction of such a project.[40]

(4) The most reasonable projected construction costs for the hypothetical recreational development are estimated at $2,371,000, as of July, 1985, rather than $1,800,00, as presented by HRG.

Finally, Mr. Reilly testified that the value of the hypothetical business venture would relate to the value of the land only if the land were so unique as to be the only possible location where the proposed business venture could be operated. He believed, however, that other tracts of vacant land existed in the area that could better accommodate such a resort.

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property is improved and generates a measurable, predictable income stream on the valuation date. In the instant case, the Nelson Mine property neither was improved nor generated an income stream. Therefore, the Reilly Report concluded that the income approach was inappropriate.

[40] Mr. Reilly testified that the discount rate Mr. Shoemaker utilized was too low to attract venture capital "given the speculative nature of this venture".

3. The Clemmer Report

Luther S. Clemmer,[41] a mining engineer, evaluated the Hawley Report's mining analysis and determined the fair market value of the mineral interests in the donated property.[42] The Clemmer Report stated that although minerals may have been present on both the patented and unpatented acres, it was not economically feasible to mine the minerals on the donation date.[43] The Clemmer Report used the income approach to value,[44] and concluded that a mining venture on the donated property would have had a negative cash flow. The Clemmer

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[41] Mr. Clemmer received a B.S. in mining engineering from the University of Minnesota, an LL.B. from LaSalle University, and has completed graduate courses in mineral economics at the Colorado School of Mines. He has over 40 years of experience with private mining companies, with the Federal government, and as a consulting mining. engineer and appraiser.

[42] Mr. Clemmer did not visit the donated property. He based his evaluation on documents provided by respondent. However, Mr. Clemmer has experience evaluating other nearby copper properties.

[43] This conclusion is based on the assumption that the small ore reserve (only 90,000 tons) and short mine life (7 years) would make the property unattractive to mining companies and investors.

[44] The Clemmer Report defined the income approach as determining anticipated income by "developing the annual income stream less the cost of operation to arrive at a net profit."

Report used operating costs of $99 per ton,[45] along with a 25-percent discount rate (given the relatively high degree of risk associated with this type of mining venture). Because the gross value of the ore was determined to be $70 per ton, the Clemmer Report computed a $29 loss per ton of mined ore. Therefore, according to Mr. Clemmer, the highest and best use of the property was not mining. The Clemmer Report concluded that "the mineral estate had no value for mining on July 30, 1985, and its fair market value is appraised at ZERO."

4. The Paschall Report

Robert F. Paschall,[46] a geologist, also prepared a report critiquing the assertions of the Hawley Report

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[45] Mr. Clemmer arrived at the $99 per ton operating cost figure as follows:

	Cost Per Ton
Mining	$40.00
Milling	5.00
Transportation	19.00
Marketing:	
Refining	8.00
Smelting	8.00
General & Admin.	6.72
Legal/permitting	.55
Insurance/travel	2.17
Startup & exploration	3.89
Interest	1.11
Reclamation	.11
Camp	2.61
10% Contingency	1.72
Total	98.88

[46] Mr. Paschall received a B.A. in geology from the University of California at Los Angeles (UCLA) and has done

concerning mineral deposits. Mr. Paschall concluded that the copper deposits on the donated property were in fact small and had no value on the date of donation because of: (1) The unpredictable geology of the mineral deposits; (2) the minuscule reserve of measured ore; (3) the poor financial condition of the copper industry; and (4) the high operating cost of extracting copper versus the low market price of copper.[47] With regard to the final factor, Mr. Paschall wrote:

> The entire copper industry was in severe financial straits at the June 1985 date of this appraisal, because the price of copper had declined from 97 cents [per] pound in 1980 to only 67 cents per pound. Operating costs had not similarly decreased, so copper mining was then uneconomic not only at Glacier Creek, but also at giant active copper mines in Utah, Arizona, and South America. It was thus not a time when even the most optimistic of miners would

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graduate work in the field at both UCLA and Oregon State University. He has taken appraisal courses at the Colorado School of Mines. He has 20 years of experience as a geologist in industry, followed by 16 years as senior mining appraisal engineer for the State of California, and 11 years as a private consultant.

We note that Mr. Paschall did not visit the donated property. He did not believe that a visit was necessary because available reports on the geology and ore deposits (provided by respondent) were voluminous and could not be duplicated without several months of field work.

[47] Mr. Paschall also testified that: (1) The donated property's topography would make it difficult to mine; (2) transporting the copper to a smelter would be both expensive and difficult; and (3) the short mining season would make mining unprofitable.

have invested in small deposits in a remote location that was subject to long and stormy winters.

In Mr. Paschall's opinion, the above factors rendered the deposit unprofitable to mine. As further support for his conclusion, Mr. Paschall noted that four major companies over a period of some 43 years deemed the deposit unprofitable to mine.

II. Discussion

A. Income Stream Approach vs. Comparative Sales Approach

As stated, the Hawley Report used the income stream or discounted cash-flow analysis to value the patented acres as a hypothetical recreational resort. In our opinion, such an approach is improper because the patented acres were unimproved and were not generating income.[48] We believe the comparable sales approach is the proper method to be used in valuing the patented acres. See, e.g., *Wolfsen Land & Cattle Co. v. Commissioner*, 72 T.C. 1, 19 (1979); *Estate of Fawcett v. Commissioner*, 64 T.C. 889, 899 (1975); *Kenroy, Inc. v. Commissioner*, T.C. Memo. 1984-232; *Estate of Stanton*, T.C. Memo. 1989-341. The comparable sales approach involves gathering information on sales of property similar to the donated property, then making adjustments for various differences between the "comparables" and the property being appraised. *Estate of Soruill*

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[48] Mr. Reilly testified that using the income stream approach in this case "would be absolutely untraditional".

v. Commissioner, 88 T.C. 1197, 1229 n.24 (1987). The "comparable sales" method is a commonly accepted method of appraising real estate. Expert opinions based.on the comparable sales method have been found probative by this Court on numerous occasions. See, e.g., *Estate of Stanton v. Commissioner, supra; Estate of Harms v. Commissioner,* T.C. Memo. 1981-320.

In our opinion, the hypothetical lodge analysis Mr. Shoemaker performed was in reality a feasibility study, prepared to attract investors. Mr. Shoemaker estimated the value of a going-concern hotel business and simply assigned that value to the patented acres. We agree with Ms. Black-Smith and Mr. Reilly that such analysis is inappropriate to this case. Even assuming arguendo that this analysis was appropriate, Mr. Shoemaker's assumptions were for the most part unverifiable and refuted by respondent's experts.

Further, Mr. Shoemaker failed to consider numerous attributes of the patented acres that are not conducive to building a recreational development. We agree with respondent's experts that due to the steep slope, lack of access, and remoteness, the patented acres are not physically suited for a resort.

In essence, Mr. Shoemaker acted more as an advocate for petitioners' benefit than as an unbiased, independent expert. The valuation he determined for the patented acreage (exclusive of the mineral interests) was so egregiously exaggerated that in our opinion it surpassed the ludicrous.

B. The Injunction

In valuing the donated property's mineral interests, the Hawley Report did not consider the July 22, 1985, injunction.[49] The injunction prohibited mining in the Park absent a court order. Mr. Hawley admitted at trial that in order to properly take the injunction into account, the value he attributed to the minerals would need a substantial downward adjustment. He did not provide the Court with an adjusted figure.

Petitioners contend that although any possible mining would have had to be delayed until 1990 when the injunction was ultimately lifted, it would not have been barred forever. We agree; however, on July 30, 1985, the date of donation, there was no indication whether the injunction would *ever* be lifted. Hindsight is always 20-20. We have held that the fair market value of property must be adjusted to take into account any legal restrictions with regard to the marketability of such property on the date of donation. See, e.g., *Cooley v. Commissioner*, 33 T.C. 223, 225 (1959), affd. 283 F.2d 945 (2d Cir. 1960); *Thornton v. Commissioner*, T.C. Memo. 1988-479, affd. without published opinion 908 F.2d 977 (9th Cir. 1990). The Hawley Report failed to do so. We believe that the presence of the injunction decreased the value of the mineral interests considerably, as a prospective purchaser on the date of donation would not know whether mining would ever be possible.

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[49] Mr. Hawley testified that he did not consider the injunction in his report because he wrote it before the injunction took effect.

In addition, some inconsistencies and inaccuracies exist with regard to the Hawley Report's evaluation of the speculative mining venture. Mr. Hawley testified that such venture was not a "high risk operation" and consequently assigned a 10-percent discount rate to the project. However, the Hawley Report arrived at a different conclusion, stating that the "development of any mine has to be viewed as one of high risk." Mr. Hawley also testified that he mistakenly failed to make any assumptions for risk analysis with regard to the present net worth of the minerals. Further, we note that the Hawley Report failed to include exploration, transportation, smelting, marketing, and other costs necessary for this type of mining venture and failed to consider the added expenses of mining in Alaska versus similar costs in the lower 48 States.

C. The Mineral Interests

Messrs. Clemmer and Paschall determined that the mineral interests of the donated property had a zero value on the date of donation. They concluded that because of the combination of the high costs of extracting the copper and the low prices copper would command, it would not have been economically feasible to mine the property at the time of donation. We found Messrs. Clemmer and Paschall to be excellent witnesses and believe that their detailed analyses provide strong evidence for their conclusions.

Nevertheless, Messrs. Clemmer and Paschall failed to consider the speculative value of the mining rights: copper prices could always increase and the injunction could

be lifted. As a result, it could have become economically feasible to mine the property. Thus, a speculator would ascribe *some* value to the mineral interests based on the fact that conditions could change in the future. We believe that the mineral claims had *some* value for speculative purposes.

D. Conclusion

We have closely considered the qualifications and experience of the parties' experts, their particular knowledge and experience in valuing vacant land and mineral interests, as well as the substance and reasoning of their reports. We found respondent's expert witness reports and the testimony from such witnesses more useful and persuasive than those of petitioners' witnesses. We agree with Ms. Black-Smith that the comparable sales method was the more appropriate method to be used in this case, and that the patented acres were not suitable for recreational development. We also agree with Messrs. Clemmer and Paschall that it was not economical to mine the donated property on July 30, 1985. The Hawley Report's valuation of the donated property at $2,750,000 was based on two improbable and unrealistic assumptions: (1) A hypothetical use of the patented acres as a recreational resort (even though the property was vacant, remote, steep, and had limited access); and (2) the speculative mining project (even though it was illegal to mine the property without a court order and it was uneconomical

to do so[50]). *See Stanley Works v. Commissioner*, 87 T.C. 389, 400 (1986). We have rejected expert testimony where the witness' opinion of value was so exaggerated that his testimony was incredible. See *Dean v. Commissioner*, 83 T.C. 56, 75 (1984). Likewise, here, we reject the exaggerated conclusions pronounced by petitioners' experts.

T.W. Van Zelst testified extensively at trial regarding the donated property.[51] We found his testimony to be self-serving and frequently contradictory. For example, in 1977, T.W. Van Zelst testified before the House Subcommittee on General Oversight and Alaska Land that the property was dangerous for tourists and inaccessible. But at the trial of this case, he testified to the exact opposite. Also, his statements and photographs regarding access and so-called "improvements" on the donated property were contradicted by Kit Mullen, an unbiased National Park Service employee who worked on the property in

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[50] Some of the corporate entities involved herein spent substantial funds in exploration costs but never commercially mined the property. In addition, the poor financial condition of the copper industry, along with the small amount of actual measured ore, would surely have discouraged potential investors.

[51] T.W. Van Zelst produced at trial his own compilation report of comparable sales to supplement the Hawley Report's income stream approach. These comparables appear faulty for several reasons: (1) Some of the prices used in the report include asking or listing prices instead of actual purchase prices; (2) many of the comparables are located several hundred miles from the Nelson Mine property; and (3) many are small lots which cannot be compared to the market prices for larger tracts of land such as the Nelson Mine property. We therefore disregard his comparables.

1985. In sum, we found T.W. Van Zelst not to be a credible witness.

Based upon our consideration of all the valuation evidence introduced through testimony and documentation, we conclude that petitioners have not carried their burden to prove a $2,750,000 fair market value for the donated property on July 30, 1985. See, e.g., *Anselmo v. Commissioner*, 80 T.C. 872, 885-886 (1983), affd. 757 F.2d 1208 (11th Cir. 1985). On the other hand, we believe that respondent has submitted highly probative evidence that the fair market value of the patented acres (exclusive of the subsurface interests) was $28,000 on July 30, 1985. However, in our judgment, $10,000 must be added to this figure for the possibility of future mineral extraction from both the patented and unpatented acres. The total $38,000 ($28,000 + $10,000) value is more than the price T.W. Van Zelst paid for the donated property in 1983,[52] which in and of itself is probative evidence of the property's fair market value on the date donation.[53] See, e.g., *Chiu v. Commissioner*, 84 T.C. 722, 734-736 (1985). We thus hold

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[52] While T.W. Van Zelst testified that he paid $40,000 for the donated property, the record reflects a price of $30,174. We assume that the $40,000 amount refers to the total he paid Cooper for the donated property, the International Harvester Scout II vehicle, and other personal property. However, $30,174 was paid for the donated property.

[53] Both Ralph Cohen, former senior corporate counsel of Cooper and the secretary of Geneva Pacific, and Alan Riedel, who worked at Cooper at the time and was involved in the sale of the donated property to T.W. Van Zelst, testified that Cooper would not have sold the donated property for a minimal amount if it believed the property was worth millions of dollars.

that the fair market value of the patented and unpatented acres on the date of donation was $38,000.[54]

We have considered petitioners' other arguments and find them to be without merit.

Issue 2. 50-Percent Charitable Limitation

We need not address the issue of whether section 170(b)(1)(C)(iii) elections were properly made. This issue falls by the wayside in light of our holding that the fair market value of the donated property was $38,000 rather than $2,750,000.

Issue 3. Negligence Additions to Tax

The third issue is whether petitioners are liable for additions to tax for negligence or intentional disregard of rules or regulations pursuant to section 6653(a)(1) and (2) for 1985, and section 6653(a)(1)(A) and (B) for 1986 and 1987.

Section 6653(a)(1), which was redesignated as 6653(a)(1)(A) for taxable periods for which a return is due after December 31, 1986, provides that if any part of an underpayment of tax is due to negligence or intentional disregard of rules or regulations, there shall be added to the tax an amount equal to 5 percent of the underpayment. Section 6653(a)(2), which was redesignated as

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[54] Because petitioners failed to prove either the value of the royalty rights T.W. Van Zelst waived when he purchased the donated property, or the impact of the Cenco option on the donated property, we attribute no value to those factors.

6653(a)(1)(B) for taxable periods for which a return is due after December 31, 1986, provides that if any part of an underpayment of tax is due to negligence or intentional disregard of rules or regulations, there shall be added to the tax an amount equal to 50 percent of the interest payable under section 6601 with respect to the portion of such underpayment which is attributable to negligence.

Negligence is the lack of due care or failure to do what a reasonable and ordinarily prudent person would do under the circumstances. *Neely v. Commissioner*, 85 T.C. 934, 947 (1985). Respondent's determination of negligence in the notices of deficiency is presumed to be correct and petitioners have the burden of proving that it is erroneous. Rule 142(a); *Luman v. Commissioner*, 79 T.C. 846, 860-861 (1982). Respondent has the burden of proving the increased negligence additions asserted in the amended answers.

Mere reliance on an appraiser or expert in a matter does not automatically shield a taxpayer from the negligence addition; a taxpayer must affirmatively establish that his reliance was reasonable, prudent, and in good faith. *Horn v. Commissioner*, 90 T.C. 908, 942 (1988); *Vesper v. Commissioner*, T.C. Memo. 1989-358.

Ralph Brown and T.W. Van Zelst were the only petitioners who testified in these cases. They stated that when they filed their Federal income tax returns for the years in issue, they relied on the Hawley Report and the advice of their accountant. We cannot agree that their reliance was reasonable, prudent, and in good faith. Both of these individuals are sophisticated investors. They

should have known the Hawley Report grossly overstated the fair market value of the donated property. They should have been aware that nothing had occurred to substantially increase the value of the property between the time T.W. Van Zelst purchased the property and the time it was donated. Indeed, with regard to the mineral interests, copper prices were declining. And, they should have realized that the hypothetical resort was unrealistic and that at the time of donation mining was illegal and not economically feasible. Common sense should have come into play.

Indeed, common sense should have come into play for all petitioners. It was unreasonable for petitioners to expect that property purchased for $30,174 would increase to a value of $2,750,000 just 2 years later, generating such enormous charitable contribution deductions. See, e.g., *LaVerne v. Commissioner*, 94 T.C. 637, 652-653 (1990), affd. without published opinion 956 F.2d 274 (9th Cir. 1992); *Pasqualini v. Commissioner*, T.C. Memo. 1994-323 and 103 T.C. 1 (1994); *Weitz v. Commissioner*, T.C. Memo. 1989-99. Thus, based upon all of the evidence before us, we hold that petitioners are liable for the negligence additions to tax for the years in issue.[55]

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[55] The amount of the additions will be calculated in the Rule 155 computations, based on the figures stated in the amended answers and adjusted to reflect our opinion herein.

Issue 4. Valuation Overstatements Additions to Tax

The fourth issue is whether petitioners are liable for section 6659 additions to tax for valuation overstatements.[56] Pursuant to section 6659(c), a valuation overstatement exists if the value of any property claimed on a return is 150 percent or more of the amount determined to be the correct valuation of such property. For this addition to tax to apply, the underpayment for the taxable year attributable to the valuation overstatement must be at least $1,000. Sec. 6659(d). Further, with respect to charitable deduction property, the amount of the addition to tax is equal to 30 percent of the underpayment. Sec. 6659(f)(1).

The Secretary may waive this addition if the taxpayers are able to demonstrate that there was a reasonable basis for the valuation claimed and the claim was made in good faith. Sec. 6659. We believe that here the Secretary correctly did not waive the addition. We have recently held that it was not an abuse of the Secretary's discretion to refuse to waive the section 6659 addition where the values for deduction purposes were 63 times the amount originally invested. See *Pasqualini v. Commissioner*, T.C. Memo. 1994-323. Here, petitioners attempted to claim a charitable contribution deduction for approximately 91 times the amount T.W. Van Zelst paid for the property 2 years prior to donation. They grossly overstated the value of the donated property.

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[56] We note that here, too, respondent has the burden of proving the increased sec. 6659 additions to tax as asserted in the amended answers.

Petitioners argue that the Secretary's refusal to waive the valuation overstatement additions was an abuse of discretion. They contend that there was a reasonable basis for the valuation claimed, and that the claim was made in good faith. We disagree. Respondent properly determined the section 6659 additions and the Secretary properly did not waive such additions.

Issue 5. Additional Interest

The final issue for decision is whether petitioners are liable for additional interest pursuant to section 6621(c) (formerly section 6621(d)) for the years in issue. Section 6621(c) provides for an interest rate of 120 percent of the adjusted rate established under section 6621(b) if there is a "substantial underpayment" (an underpayment in excess of $1,000) in a taxable year "attributable to 1 or more tax-motivated transactions". Tax-motivated transactions include valuation overstatements. Sec. 6621(c)(3).

Petitioners made "blatant misuse of the charitable donation provisions" and "participated in a scheme to generate egregious charitable contribution deductions through the gross overvaluation of the items donated." See *Johnson v. Commissioner*, 85 T.C. 469, 483-484 (1985). In this case, the underpayment of taxes exceeds $1,000 for each year. Because any valuation overstatement is a tax-motivated transaction, the increased rate of interest set forth in section 6621(c) is applicable to each of the petitioners.

To reflect the foregoing,

Decisions will be entered under Rule 155.

UNITED STATES TAX COURT

THEODORE W. VAN ZELST and LOUANNE H. VAN ZELST,	)	Docket No. 22030-90
Petitioners,	)	
v.	)	
COMMISSIONER OF INTERNAL REVENUE,	)	
Respondent.	)	

DECISION

Pursuant to the opinion of the Court filed August 16, 1995 and incorporating herein the facts recited in respondent's computation as the findings of the Court, it is

ORDERED AND DECIDED: That there are deficiencies in income tax and additions to tax due from the petitioners as follows:

		Additions to tax – I.R.C. §	
Year	Deficiency	6653(a)	6659
1985	$14,914.00	$746.00	$4,474.00
1986	35,016.00	1,751.00	10,505.00
1987	32,801.00	1,640.00	9,840.00

/s/ Julian Jacobs
Judge

Entered: JAN 4 1996

The parties stipulate that the foregoing decision is in accordance with the opinion of the Court and the respondent's computation, and that the Court may enter this

decision, without prejudice to the right of either party to contest the correctness of the decision entered herein.

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Internal Revenue Service

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Date: 12/27/95

UNITED STATES TAX COURT

JEAN VAN ZELST, Petitioner,	)	
v.	)	Docket No. 22031-90
COMMISSIONER OF INTERNAL REVENUE, Respondent.	)	

DECISION

Pursuant to the opinion of the Court filed August 16, 1995, and incorporating herein the facts recited in respondent's computation as the findings of the Court, it is

ORDERED AND DECIDED: That there are deficiencies in income tax and additions to tax due from the petitioner as follows:

		Additions to tax – I.R.C. §	
Year	Deficiency	6653(a)	6659
1985	$4,312.00	$216.00	$1,294.00
1986	6,464.00	323.00	1,939.00
1987	7,327.00	366.00	2,198.00

/s/ Julian J. Jacobs
Judge.

Entered: Jan 4 1996

The parties stipulate that the foregoing decision is in accordance with the opinion of the Court and the respondent's computation, and that the Court may enter this

decision, without prejudice to the right of either party to contest the correctness of the decision entered herein.

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Date: 12/12/95

Date: 12-14-95

UNITED STATES TAX COURT

RALPH E. BROWN and SUZANNE BROWN,	)	
Petitioners,	)	Docket No. 22032-90
v.	)	
COMMISSIONER OF INTERNAL REVENUE,	)	
Respondent.	)	

DECISION

Pursuant to the opinion of the Court filed August 16, 1995, and incorporating herein the facts recited in respondent's computation as the findings of the Court, it is

ORDERED AND DECIDED: That there are deficiencies in income tax and additions to tax due from the petitioners as follows:

		Additions to tax – I.R.C. §	
Year	Deficiency	6653(a)	6659
1985	$31,112.00	$1,556.00	$9,334.00
1986	34,231.00	1,712.00	10,269.00
1987	1,577.00	79.00	473.00

/s/ Julian J. Jacobs
Judge.

Entered: Jan 4 1996

The parties stipulate that the foregoing decision is in accordance with the opinion of the Court and the respondent's computation, and that the Court may enter this decision, without prejudice to the right of either party to contest the correctness of the decision entered herein.

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Date: _____

Date: 12-14-95

UNITED STATES TAX COURT

BRADLEY ORVIETO and ANNE L. ORVIETO, Petitioners,	)	Docket No. 22033-90
v.	)	
COMMISSIONER OF INTERNAL REVENUE, Respondent.	)	

DECISION

Pursuant to the opinion of the Court filed August 16, 1995, and incorporating herein the facts recited in respondent's computation as the findings of the Court, it is

ORDERED AND DECIDED: That there are deficiencies in income tax and additions to tax due from the petitioners as follows:

		Additions to tax – I.R.C. §	
Year	Deficiency	6653(a)	6659
1985	$3,315.00	$166.00	$995.00
1986	12,813.00	641.00	3,844.00
1987	19,151.00	958.00	5,745.00

/s/ Julian J. Jacobs
Judge.

Entered: Jan 4 1996

The parties stipulate that the foregoing decision is in accordance with the opinion of the Court and the respondent's computation, and that the Court may enter this decision, without prejudice to the right of either party to contest the correctness of the decision entered herein.

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Date: 12/12/95

Date: 12-14-95

UNITED STATES TAX COURT

THEODORE D. VAN ZELST, Petitioner,	)	
v.	)	Docket No. 22034-90
COMMISSIONER OF INTERNAL REVENUE, Respondent.	)	

DECISION

Pursuant to the opinion of the Court filed August 16, 1995, and incorporating herein the facts recited in respondent's computation as the findings of the Court, it is

ORDERED AND DECIDED: That there are deficiencies in income tax and additions to tax due from the petitioner as follows:

		Additions to tax – I.R.C. §	
Year	Deficiency	6653(a)	6659
1985	$4,671.00	$234.00	$1,401.00
1986	6,947.00	347.00	2,084.00
1987	23,774.00	1,189.00	7,132.00

/s/ Julian J. Jacobs
Judge.

Entered: Jan 4 1996

The parties stipulate that the foregoing decision is in accordance with the opinion of the Court and the respondent's computation, and that the Court may enter this

decision, without prejudice to the right of either party to contest the correctness of the decision entered herein.

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Date: 12-14-95

Supreme Court, U.S.
FILED
JUN 12 1997
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(2)

No. 96-1627

In the Supreme Court of the United States

OCTOBER TERM, 1996

THEODORE VAN ZELST, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether additions to tax for underpayments of tax resulting from negligence (26 U.S.C. 6653(a) (1986)) and from valuation overstatement (26 U.S.C. 6659 (1986)) were correctly imposed against petitioners.

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In the Supreme Court of the United States

OCTOBER TERM, 1996

No. 96-1627

THEODORE VAN ZELST, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-16a) is reported at 100 F.3d 1259. The opinion of the Tax Court (Pet. App. 18a-58a) is reported at 70 T.C.M. (CCH) 435.

JURISDICTION

The judgment of the court of appeals was entered on November 15, 1996. The petition for rehearing was denied on January 15, 1997 (Pet. App. 17a). The petition for a writ of certiorari was filed on April 14, 1997. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. On their federal income tax returns for 1985, 1986, and 1987, petitioners claimed charitable contribution deductions for their donation to the National Park Service of interests in real property located in a remote part of Alaska, approximately 230 miles northeast of Anchorage (Pet. App. 18a-22a, 25a). The donated property consists of 93 "patented" acres, in which petitioners had a fee simple interest, and 154 "unpatented" acres, in which petitioners held only subsurface or mineral rights. The patented acres are located on very steep terrain on the north side of a mountain that limits their exposure to sunlight. Access to the location of these tracts is available by helicopter or small plane. Such access is inhibited, however, by Glacier Creek, which has no bridge and which separates the patented acres from the nearest airstrip (*id.* at 25a-26a, 41a).

Petitioners acquired this property in 1983 for approximately $30,000 (Pet. App. 5a). Before that date, four separate companies had attempted to mine the property over a period of 43 years. All had concluded, however, that it was not feasible to do so (*id.* at 47a). On their tax returns, petitioners nonethelesss claimed that the donated property had a value of $2.75 million, and they asserted a charitable deduction for that amount. On audit of those returns, the Commissioner determined that petitioners had grossly overstated the actual fair market value of the property on the date that it was donated (*id.* at 18a-22a, 30a, 57a). The Commissioner therefore disallowed all but a small amount of the claimed charitable deduction and further concluded that petitioners were liable for additions to tax for negligence under 26 U.S.C.

6653(a) (Supp. IV 1986) and for valuation overstatement under 26 U.S.C. 6659 (Supp. IV 1986) (Pet. App. 53a, 55a).[1]

2. Petitioners sought review of the Commissioner's determinations in the Tax Court. Petitioners sought to justify their $2.75 million valuation based upon testimony concerning the potential value of the property as a resort and as a copper mine. The Tax Court found, however, that the fair market value of the property on July 30, 1985, the date of its donation, was only $38,000 (Pet. App. 30a-31a, 53a). In reaching that conclusion, the court relied on the testimony of (i) experts in real estate development who concluded that the property had no value as a potential resort and had a value of only $28,000 as undeveloped real estate and (ii) experts in mineral extraction who concluded that the property had only a minimal, speculative value as a mine (*id.* at 38a-51a).

The Tax Court also concluded that petitioners were liable for the addition to tax for negligence (Pet. App. 54a-57a). The Tax Court stated that "[m]ere reliance on an appraiser or expert in a matter does not automatically shield a taxpayer from the negligence addition; a taxpayer must affirmatively establish that his reliance was reasonable, prudent, and in good faith" (*id.* at 55a). In rejecting petitioners' claim that they relied in good faith on an appraisal, the court noted that only two of the petitioners had testified, that the two who testified were sophisticated investors, and

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[1] After the years in suit, the provisions of the Internal Revenue Code imposing the additions to tax for negligence and for valuation overstatement were revised. Those additions to tax are currently imposed under 26 U.S.C. 6662. See Omnibus Budget Reconciliation Act of 1989, Pub. L. No. 101-239, § 7721, 103 Stat. 2106.

that facts known to these petitioners put them on notice that the expert appraisal they obtained to support their claimed deductions greatly overstated the value of the property (*id.* at 55a-56a).[2] The court also noted that "common sense should have come into play for all petitioners [since] [i]t was unreasonable for petitioners to expect that property purchased for $30,174 would increase to a value of $2,750,000 just 2 years later" (*id.* at 56a).

The court further found that the Commissioner had properly imposed the addition to tax for valuation overstatements under Section 6659 (Pet. App. 57a-58a). The court noted that "petitioners attempted to claim a charitable contribution deduction for approximately 91 times the amount T.W. Van Zelst paid for the property 2 years prior to donation" (*id.* at 57a), that petitioners did not have a reasonable basis for the value they claimed on their returns, and that their claimed deduction was therefore not made in good faith (*id.* at 58a).

3. The court of appeals affirmed (Pet. App. 1a-16a). The court held that the Tax Court's finding that the subject property had a fair market value of $38,000 on the donation date was not clearly erroneous (*id.* at 8a):

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[2] These facts included (i) the absence of any event that would have substantially increased the value of the property between the date petitioners acquired it for approximately $30,000 and the date of its donation to the Park Service; (ii) the decline in copper prices during that same period; (iii) the unrealistic nature of the "hypothetical resort" analysis used in the appraisal prepared for petitioners; and (iv) the economic infeasibility of mining on the property at the time of the donation (Pet. App. 56a).

> Evidence was presented on both sides; the trier of fact was entitled to choose.

The court emphasized that such disputed questions of fact are "for the Tax Court to resolve" (*ibid.*). The court added, however, that "[o]ur own view, to the extent it matters, is that the trial judge was on the mark" (*ibid.*).

The court of appeals further concluded that the Tax Court correctly upheld the additions to tax imposed for negligence and gross overvaluation (Pet. App. 11a-16a). The court rejected petitioners' claim that they had reasonably relied on an expert appraisal because "the appraisal is nonsense on its own terms" (*id.* at 8a). The court noted that $2.10 million of the $2.75 million value attributed to the property by petitioners' expert was associated with its proposed use as a resort (*id.* at 15a-16a). The court emphasized that the remoteness of the property (along with numerous other factors) made it highly unlikely that a profitable resort could be constructed on the property (*id.* at 7a-10a, 16a). The court succinctly concluded that the entire record demonstrated that petitioners "had to have known that [their valuation] estimate was hooey, the sort of number ginned up to put one over on the revenooers" (*id.* at 15a).

The court of appeals also found unpersuasive petitioners' assertion that the Alaska Regional Director of National Parks had advised them that their expert "is the best you can get" (Pet. App. 15a). The court explained that "The Park Service wants to encourage donations, and sky-high appraisals do so" (*ibid.*). The court pointed out, however, that "[t]he Park Service cannot bind the Revenue Service" (*ibid.*). Moreover, the expert that the Park Service had recommended

had not prepared the resort valuation figures, and "[i]t was the ludicrous attribution of $2.1 million to this [property as a potential resort] that propelled the parcel's total valuation into the stratosphere. The Tax Court did not exceed the scope of the reasonable in its evaluation of these events." *Id.* at 16a.

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Further review is therefore not warranted.

1. Petitioners contend that they should not be subject to the additions to tax for negligence and valuation overstatement. They assert that such additions to tax are improper because they relied on an appraisal report prepared by an expert in claiming their grossly inflated charitable contribution deductions. The courts below properly concluded, however, that petitioners' reliance on the appraisal report prepared by their expert was not reasonable in the circumstances (Pet. App. 14a-15a, 55a-56a). Further review of this factual determination, concurred in by both courts below, is not warranted. See *Tiffany Fine Arts, Inc.* v. *United States*, 469 U.S. 310, 317-318 n.5 (1985).

As the court of appeals emphasized, the resort property appraisal on which petitioners purport to have relied was "nonsense on its own terms" (Pet. App. 8a). Moreover, the tremendous gap between the $30,000 price paid for the property by petitioner Van Zelst in 1983 and the $2.75 million value assigned to the property in the appraisal report for 1985 would have put a reasonably prudent person on notice that something was amiss. Since petitioners had detailed knowledge

about the substantial problems that made extraction of minerals from the property economically infeasible —and which also precluded other types of commercial exploitation—the court of appeals properly concluded that their purported reliance on the appraisal report was entirely unjustified. The record amply supports the court's emphatic conclusion that the expert appraisal was obviously "hooey, the sort of number ginned up to put one over on the revenooers" (*id.* at 15a).

2. Petitioners err in contending (Pet. 12-15) that the decision in this case conflicts with decisions of other circuits (Pet. 12-15, citing *McMurray* v. *Commissioner*, 985 F.2d 36 (1st Cir. 1993); *Chamberlain* v. *Commissioner*, 66 F.3d 729 (5th Cir. 1995); *Mauerman* v. *Commissioner*, 22 F.3d 1001 (10th Cir. 1994); *Sammons* v. *Commissioner*, 838 F.2d 330 (9th Cir. 1988)). As the courts below noted (Pet. App. 14a, 55a), and as the cases cited by petitioners demonstrate, reliance on professional opinion can create a defense to the imposition of additions to tax for negligence and valuation overstatement only if that reliance is objectively reasonable and in good faith. *Chamberlain* v. *Commissioner*, 66 F.3d at 732. As the court of appeals stated in this case, "[a]n appraisal may show that the taxpayer acted both prudently and reasonably, but it does not compel this inference" (Pet. App. 14a). None of the cases cited by petitioners is inconsistent with the principle that "a taxpayer must affirmatively establish that his reliance was reasonable, prudent, and in good faith" (*id.* at 55a). To the contrary, it is well established that reliance on professional opinion is not a defense to additions to tax when such reliance is not reasonable. See *Sacks* v. *Commissioner*, 82 F.3d 918, 920-921 (9th Cir. 1996);

Chakales v. *Commissioner*, 79 F.3d 726, 729 (8th Cir.), cert. denied, 117 S. Ct. 85 (1996); *Westbrook* v. *Commissioner*, 68 F.3d 868, 880-881 (5th Cir. 1995); *Goldman* v. *Commissioner*, 39 F.3d 402, 408 (2d Cir. 1994); *Illes* v. *Commissioner*, 982 F.2d 163, 167 (6th Cir. 1992), cert. denied, 507 U.S. 984 1579 (1993); *Accardo* v. *Commissioner*, 942 F.2d 444, 452-453 (7th Cir. 1991), cert. denied, 503 U.S. 907 (1992). The factual determination of the courts below that the purported reliance of petitioners on the facially implausible report of their appraisers was not reasonable and was not in good faith is amply supported by the record. That factual determination does not warrant further review.

3. Petitioners contend that this Court should review the decision below because the court of appeals denigrated the reputation of the National Park Service (Pet. 18-19). Petitioners, of course, do not represent the Park Service. Moreover, it is plain that petitioners, perhaps for their own purposes, have exaggerated the purported insult. Compare Pet. 19 with Pet. App. 15a-16a. The observation of the court of appeals that the Park Service wanted to encourage donations of property, and that "sky-high" appraisals would do so (*id.* at 15a), was made in the context of pointing out that the interests of the Park Service and the Internal Revenue Service were divergent. That observation, which did no more than state the obvious, clearly does not warrant review by this Court.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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In The
Supreme Court of the United States
October Term, 1996

THEODORE VAN ZELST and LOUANN H. VAN ZELST, JEAN VAN ZELST-BIERNER, RALPH E. BROWN and SUZANNE BROWN, BRADLEY ORVIETO and ANNE L. ORVIETO, and THEODORE D. VAN ZELST,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

REPLY TO BRIEF IN OPPOSITION

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INTRODUCTION

The government's Brief for the Respondent in Opposition (the "Opposition Brief" or "Opp. Br.") is most significant not for what it says but rather for what it fails to say. Specifically, it fails to cite a single case in which reliance on an *expert valuation* opinion was found to be unreasonable. The mandate of the First Circuit Court of Appeals in *McMurray v. Commissioner*, 985 F.2d 36 (1st Cir. 1993), and of the Ninth Circuit Court of Appeals in *Sammons v. Commissioner*, 838 F.2d 330 (9th Cir. 1988) is clear: a taxpayer is entitled to rely on a valuation opinion by a qualified expert even where the expert values property at a price many times that of the acquisition cost. Nothing states to the contrary *except for the lower court decisions in this case*.

The cases cited by the government, all of which deal with alleged reliance on accounting advice (as opposed to a valuation opinion), do not ameliorate this conflict. Instead, the cases only demonstrate just how exceptional the circumstances must be before reliance on any professional advice can be disregarded. The lower court's decision to impose negligence and valuation overstatement penalties on these petitioners who even went beyond the expert report and, in good faith, gathered their own supporting comparables was clear error warranting reversal.

Finally, the government, in the Opposition Brief, completely misses the point of the lower court's attribution of a desire for "sky-high" appraisals to the National Park Service. The court did not, as the government claims, state that the Park Service encourages "sky-high" appraisals merely "to point out that the interests of the Park Service and the Internal Revenue Service were divergent." Opp. Br., p.

8. It is more than passing strange that not only is there no reference to this claim in the record below; there is no suggestion of any such claim by the trial court that heard and decided the matter in the first instance. Rather, as even a cursory reading of the opinion clearly reveals, the court concocted this "fact" out of whole cloth specifically to denigrate Hawley, the expert recommended by the Park Service (as well as other government officials including the Deputy Undersecretary of the Department of Interior), so as to justify the court's unsupported and maverick conclusion that petitioners did not have a good faith basis for relying on Hawley's expert valuation report. This exercise in advocacy by the Court below is consistent with that Court's quoting from *Fodor's Alaska*, written nine years after the date of donation, and never previously refered to in these proceedings, as dispositive evidence of Alaskan conditions in 1985.

As we will further demonstrate below, the Opposition Brief filed by the government demonstrates, both by its words and by its silence, why this Court should grant petitioners' request for a writ of certiorari.

ARGUMENT

1. The government's principal argument is predicated upon two assertions: (1) to avoid negligence penalties, a taxpayer's reliance upon professional advice must be reasonable; and (2) the trier of fact's determination as to the reasonableness of a party's conduct is to be accepted absent clear error. Opp.Br., p. 6. What the government fails to mention, however, is that the case law very clearly sets out a standard for reasonable reliance—a taxpayer may reasonably rely on "substantive advice" from an expert which "involved the application of the [expert's] relevant

expertise." *Chakales v. Commissioner*, 79 F.3d 726, 730 (8th Cir. 1996), quoting in part from *United States v. Boyle*, 468 U.S. 241, 251 (1985). By ignoring this principle, the lower courts in this case rendered a decision which is: (a) squarely in conflict with the decisions made by other circuit courts of appeal; and (b) clearly erroneous.

The holding of the cases cited by petitioner including, most notably, the *McMurray* and *Sammons* cases, is that a valuation of property by an expert is precisely the type of "substantive advice" which insulates a taxpayer from penalties for relying thereon. Those courts both held that a taxpayer need not "second-guess" an appraisal, even one that ascribes a value to the property many times that of the purchase price, precisely because it is reasonable to rely on "well qualified appraisers." *McMurray*, 985 F.2d at 48; *Sammons*, 838 F.2d at 337. Signally, the government's own attorneys cannot cite to a single appellate court decision (or, indeed, any decision whatsoever) which found that a taxpayer could not reasonably rely on a valuation report submitted by a qualified expert. The case at bar, which so found in the face of: (1) a government-recommended expert's contemporaneous valuation; and (2) the additional, good-faith investigation by the taxpayers including an extensive analysis of comparable sales, is in stark conflict with the 1st and 9th Circuits, in *McMurray* and *Sammons*, and departs from the standard set by this Court in *Boyle*.

The cases cited by the government demonstrate the lack of support for the lower courts' decisions:

Sacks v. Commissioner, 88 F.3d 918 (4th Cir. 1996) involved a challenge to the imposition of penalties based upon alleged reliance on advice from the taxpayers' accountants. The taxpayers in that case, however, "could not

recall any specific advice [the accountant] gave them concerning the project.." 84 F.2d at 818. The "best [the taxpayers] were able to provide" was a letter written by the accountant describing "the partnership approach to be a 'viable investment' [which] had a 'better' chance of surviving an Internal Revenue Service challenge." 82 F.3d at 919, 920. The appellate court found this vague, unspecific advice, when coupled with the taxpayers' receipt of a prospectus warning that the investment "INVOLVE[D] A HIGH DEGREE OF RISK, INCLUDING MATERIAL FEDERAL INCOME TAX RISKS," did not insulate the taxpayers from the imposition of penalties.

Obviously, the facts of this case differ dramatically from those in *Sacks*. Petitioners' expert rendered specific "substantive advice" within the area of his relevant expertise. No warning as to potential risky tax consequences was ever received by Petitioners. Thus, unlike in *Sacks*, Petitioners in this case had every reason to rely on what they were told, and no reason to "second guess" the valuation. Accordingly, the government's citation of the *Sacks* case does not resolve the conflict between the decision of the Seventh Circuit and the decision of the First and Ninth Circuits in the *McMurray* and *Sammons* cases raised by Petitioners.

Chakales v. Commissioner, 79 F.3d 726 (8th Cir. 1996), like *Sacks*, did not involve a taxpayer's reliance on specific accounting advice. There, the "advice" was only "a generalized statement that [the taxpayer] could lose money on the transaction [in question]." 79 F.3d at 730. *Chakales* does not contradict Petitioners' fundamental premise (as set forth in *McMurray* and *Sammons*), i.e., that a taxpayer is entitled to rely on specific expert advice, such as the 50-page valuation report submitted by the Hawley Group. Indeed,

the *Chakales* court directly cites that very principal as controlling. 79 F.3d at 730.

In *Westbrook v. Commissioner*, 68 F.3d 868 (5th Cir. 1995) the taxpayers' underpayment stemmed from their own "garden variety" careless record keeping — they failed to record expenses incurred in the activity in which the expenses were sustained. 68 F.3d at 881. Clearly, the taxpayers in that case could not claim justifiable reliance on expert advice that was tainted because of their own malfeasance. In *Accardo v. Commissioner*, 942 F.2d 444 (7th Cir. 1991), the taxpayer could not even produce evidence that he relied on his tax preparer at all. These cases do not, and cannot, resolve the conflict between the Seventh Circuit's decision in this case, and the decisions in *McMurray* and *Sammons*.

The last two cases cited by the government -- *Goldman v. Commissioner*, 39 F.3d 402 (2nd Cir. 1994) and *Illes v. Commissioner*, 982 F.2d 163 (6th Cir. 1992) -- each involved advice received from someone with a known direct financial stake in the project in which the taxpayers invested. In *Goldman*, the accountant was known to the taxpayers to have signed the limited partnership agreement (the investment) as the partnership's sales representative. In *Illes*, the taxpayer knew that his accountant had a personal financial stake in the matter. In addition, the taxpayer in *Illes* could not identify any specific advice given to him by the accountant.

The Hawley Group had no personal financial stake in the valuation submitted to Petitioners. Accordingly, the government's citations of *Goldman* and *Illes* do not support the Seventh Circuit's decision in this case. Nor do these

cases resolve the conflict between the circuits raised by Petitioners.

McMurray and *Sammons* stand for the proposition that a taxpayer (even a sophisticated one) can rely *solely* on an expert's *valuation opinion* and avoid the imposition of negligence penalties The cases cited by the government state that a taxpayer must go beyond *an accountant's generalized comments* and do independent investigation. In this case, which involved a specific valuation opinion, Petitioners could have started and ended with Hawley's report -- but in an abundance of caution which ensured their good faith and prudence they did more, including comparable sales analysis and consideration of improvements. The Seventh Circuit's decision to uphold the imposition of negligence and overstatement penalties on Petitioners under these circumstances cries out for reversal.

The failure of the government to find and cite contrary authority cannot be overemphasized. These are the *only* cases the government uses to justify the lower courts' findings, and to dispute the existence of a conflict. None involved a valuation opinion. None stand for the government's proposition that Petitioners' reliance on such an expert opinion was in bad faith. All of the cases involve factual situations completely the opposite of the circumstances here. Simply put, the lower courts' decision is squarely in conflict with the *McMurray* and *Sammons* decisions, and it is erroneous. This court should accept the Petition for Certiorari and reverse the circuit court's decision.

2. The decision rendered by the Seventh Circuit in the case at bar is replete with statements and misstatements of "fact" which are totally *dehors* the record. The most egregious example of these creations of "fact" is as follows:

> "What the Regional Director [of the Park Service] defined as 'the best' [the Park Service's description of Hawley] may not have been what the Commissioner or Congress had in mind. The Park Service wants to encourage donations and the sky-high appraisals do so."

Pet. Br., A.15a.

The government, in the Opposition Brief, casually dismisses this unsupported fantasy as "no more than [a] state[ment] all [of] the obvious", and further states that the lower court really meant to point out that the interest of the Park Service and the IRS were divergent. Opp. Br., 8. This argument by the government is as disingenuous as were the Seventh Circuit's statements about the Park Service.

At no point in this case have Petitioners ever asserted that the Internal Revenue Service is bound to accept the valuation opinion rendered by any expert. Rather, Petitioners have always argued only that their reliance on an expert recommended by the government was reasonable, prudent and in good faith. To take the opposite position, as did the Seventh Circuit, produces a ludicrous result. What the court and the government have told Petitioners (as well as all future donors of property) is that it is unreasonable and imprudent to rely on a valuation made by an admittedly qualified expert who was recommended by one branch of the government if another branch should disagree with that expert's conclusion. There is absolutely no authority

whatsoever which even remotely hints at supporting this absurd proposition.

This point is critical -- if it was reasonable for Petitioners to rely on the Hawley Group's recommendation, there can be no imposition of a negligence penalty. The only way that the lower court could justify its decision to uphold the imposition of negligence penalties, therefore, was to somehow denigrate Petitioners' reliance on an expert recommended to them by the very government entity to which they were donating the property at issue. In direct conflict with *McMurray* and *Sammons*, the Seventh Circuit said that Petitioners in this case, because of their sophistication, should have second-guessed the Hawley Group evaluation report. And then, perhaps mindful of the fact that this decision created a conflict with the decisions of other circuits, the Seventh Circuit justified its conclusion by saying that the Park Service encouraged "sky-high appraisals," implying, if not directly stating, that Petitioners' should have known that the Park Service and its recommended appraisers were engaged in a conspiracy to generate appraisal numbers "ginned up to put one up over on the revenooers." Pet. Br. A.15a.

There can be no other interpretation of the Seventh Circuit's remarks, regardless of the spin the government now attempts to put on them in the Opposition Brief. This was not just an attempt to highlight the difference between the Park Service and the IRS -- that would, in the government's terms, be "stating the obvious." It was rather a deliberate and unsupported attempt to justify a decision which stated that Petitioners' acted in bad faith by relying on a government-recommended expert. There is no support in the record or in the law for this conclusion, which "so far depart[s] from the accepted and usual course of judicial

proceedings...as to call for an exercise of this court's power of supervision." U.S. Supreme Court Rule 10.1(a).

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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